Regulation of issuers and investor protection in the US and EU

van der Schee, P.A.

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A transatlantic comparison of the basics of securities and corporate law

Proefschrift

ter verkrijging van de graag van doctor
aan de Universiteit van Tilburg,
op gezag van de rector magnificus,
prof. dr. Ph. Eijlander,
in het openbaar te verdedigen ten overstaan
van een door het college voor promoties
aangewezen commissie in de aula
van de Universiteit
op vrijdag 20 mei 2011 om 14:15 uur

door

Pieter Alexander van der Schee
geboren op 16 februari 1976 te Dordrecht

P.A. van der Schee

Promotor:
prof. mr. M.J.G.C. Raaijmakers

Promotiecommissie:
prof. mr. B.H. Assink
prof. dr. P.H.J. Essers
prof. mr. M.P. Nieuwe Weme
prof. mr. A.F. Verdam
prof. mr. E.P.M. Vermeulen
prof. dr. P. van der Zanden

Preface

This doctoral dissertation arose out of my research conducted at the Center for Company Law, Tilburg University, the Netherlands and during my research semester at the Law School of the University of Connecticut (USA). I started my research in April 2004 in the midst of the enfolding 'new' EU securities disclosure system as implemented after the Financial Services Action Plan and just a few years after some famous corporate scandals such as Enron, Parmalat and Ahold.
As this research developed the US and EU regulatory choices to the 'Enronitis' after the burst of the dotcom bubble appeared to differ substantially. US congress responded by enhancing, primarily by adopting the Sarbanes Oxley Act, their prevailing federal securities law disclosure and transparency system for issuers under the Securities Act 1933 and Securities Exchange Act 1934. In contrast, the EU responses were not developed by amending the new EU securities regulation, but rather by changing existing EU corporate law directives, 'new' recommendations and adopting national corporate law and (differing) 'self regulatory' corporate governance codes (principles and best practises) partly in the realm of corporate law, such as on Non-Executive Directors (NED) and corporate actions, partly within the scope of securities law (a.o. disclosure items).
These different responses in combination with the observations of Hansmann & Kraakman ('The End of History for Corporate Law', *Yale Law School No. 235,* January 2001) in one of the first articles I read on global convergence of public corporations towards a shareholder primacy model directed me to focus this thesis on a comparative legal research on the regulation of issuers. The broadness and complexity of the subject evidently induced a limitation of its scope. Although its subject is really 'global', I refrained from a global analysis and limited myself to a 'trans-Atlantic' comparative summary inventory of prevailing securities and relevant corporate law and aimed to elucidate the basic architecture as well as its major changes (and direction) of and regulatory responses to the Enronitis and financial crisis. Evidently a multitude of subjects will require further study. Most important is an extension of this research to the BRIC- and other emerging markets.

The research itself appeared to be a daunting task as a consequence of a torrent of new rules of issuer's regulation and investor protection also in reaction to the two recent major fire alarms: the 'Enronitis'(2003) and the financial crisis (2007). Therefore I am most grateful to my supervisor Professor Theo Raaijmakers. His support was indispensable in accomplishing this dissertation. Our joint research not only proved to be a lot of real academic fun, but also very inspiring. Chapter 2 and 4 build on this joint research as reflected in: M.J.G.C. Raaijmakers and P.A.van der Schee, 'Disclosure and Accounting for Issuers in between "Federal" EU Securities Law (and Mandatory Application of IFRS) and National Corporate

Law Accounting Concepts'[1] and M.J.G.C. Raaijmakers and P.A. van der Schee, Bescherming van beleggers in beurs-NV's: het enquêterecht als actie- en de business judgement rule als afweermiddel[2], in: H.J. Bruisten, M.J.G.C. Raaijmakers, A.F. Verdam, NGB-bundel 2010. I am most grateful to Ger van der Sangen, Associate Professor at Tilburg law School, for our many discussions and his continuous support, input and scrutinizing my manuscript in one of the last stages. Also the comments of Erik Koster proved to be very valuable.

I am extremely grateful to Deterink Advocaten en Notarissen and especially to Hugo Nieuwenhuizen for his support and providing me the opportunity to finish this dissertation. I also wish to thank the Business law Department of Tilburg University and the Tilburg Graduate Law School for providing the opportunity to write this doctoral thesis. The Center for Company Law did provide a most inspiring environment to conduct my research. I wish to thank the University of Connecticut School of Law for providing office space and for offering full access to the Universities' facilities during my research semester in the autumn of 2006.

I wish to thank prof. Philip Blumberg and prof. Patricia McCoy for their inspiring lectures, their interest in my research subject and who always took the time for discussion.

I am most grateful to a large group of people who gave advice and all kinds of support. I particularly want to thank Anja Huijben, Danique van Abeelen, Baukje Nuijten, Adbiba Bouichi, Marlise Zeldenrust, Henk te Niet, who passed away far to young, Marijn van Dalen, Frans Overkleeft, Janneke Leenders and all others I certainly forget to mention.

I also want to thank my closest friends Rob Slurink, Guus van Galen, Paul Roks, Erik Koster and Thijs Möller for their support over the last years. And of course Ellen Wijnings. Without her support I could not have finished this book. And last but not least I want to thank my parents for their continuous support.

1 In: P.H.J. Essers, T. Raaijmakers, R. Russo, P. van der Schee, L. van der Tas, & P. van der Zanden (eds.), *The Influence of IAS/IFRS on the CCCTB, Tax Accounting, Disclosure and Corporate Law Accounting Concepts*, Alphen aan den Rijn: Kluwer Law International 2008, p. 87-143

2 In: H.J. Bruisten, M.J.G.C. Raaijmakers, A.F. Verdam, NGB-bundel 2010.

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List of Abbreviations

AFM:	Netherlands Authority Financial Markets
AFS:	Act on Financial Supervision
AG:	Aktiengesellschaft
AGM:	Annual General Meeting
AktG:	Aktiengesetz
ALI:	American Law Institute
ASFR:	Act on Supervision Financial Reporting
BCCI:	Bank of Credit and Commerce International
BJR:	Business Judgment Rule
BoM:	Board of Management
BRIC-Country's:	Brazil, Russia, India, China
BaFin:	Bundesanstalt für Finanzdienstleistungsausicht
CC:	Combined Code
GCGC:	German Corporate Governance Code
DCGC:	Dutch Corporate Governance Code
CESR:	Committee of European Securities Regulators
CEO:	Chief Executive Officer
CFO:	Chief Financial Officer
CLAP:	Modernising Company Law and Enhancing Corporate Governance in the European Union, A Plan to Move Forward
DGCL:	Delaware General Corporate Law
DSFR:	Decision on Supervision Financial Reporting
D&O:	Directors and Officers
ECJ:	European Court of Justice
ESMA:	European Securities Market Authority
EU:	European Union
FASB:	Federal Accounting Standards Board
FSA:	Financial Service Authority
FSAP '99:	Financial Services Action Plan (1999)
FSMA:	Financial Services Markets Act
GCC:	German Cromme Codes
GerZPO:	German Zivilprozessordnung
GMS:	General Meeting of Shareholders
HGB:	Handelsgesetzbuch
HLG:	High Level Group of Company Law Experts
IAS:	International Accounting Standards
IASB:	International Accounting Standards Board
IASC:	International Accounting Standards Committee
ICGN:	International Corporate Governance Network
IFRS:	International Financial Reporting Standards
IPO:	Initial Public Offering
KapMuG:	Kapitalanleger-Musterverfahrengesetz

L&E:	Law and Economics
LSE:	London Stock Exchange
MAD:	Market Abuse Directive
MAPC:	Model Articles for Public Companies
MBCA:	Model Business Corporation Act
MD&A:	Management Discussion & Analysis
MIFID:	Markets in Financial Instruments Directive
MR:	Management Report
MS:	Member State(s)
NASDAQ:	National Association of Securities Dealers Automated Quotations
NCC:	Netherlands Civil Code
NV:	Naamloze Vennootschap/public limited corporation
NYSE	New York Stock Exchange
OECD:	Organisation for Economic Cooperation and Development
PD:	Prospectus Directive
PLC:	Public Limited Company
RMBCA:	Revised Model Business Corporation Act
SA:	Société Anonyme
SA'33:	Securities Act 1933
SB:	Supervisory Board
SE:	European Company
SEA'34:	Securities Exchange Act 1934
SEC:	US Securities and Exchange Commission
SER:	Social Economic Counsel
SOx:	Sarbanes-Oxley Act
TCI:	The Children's Investment Fund
TD:	Transparency Directive
TOD:	Takeover Directive
UK:	United Kingdom
UK CA:	UK Companies Act
UMAG:	Gesetz zur Unternehmensintegrität und Modernisierung des Anfechtungsrechts
US:	United States
US GAAP:	United States Generally Accepted Accounting Principles
VEB:	Vereniging voor Effectenbezitters/Association of Securities Owners
VOC:	Dutch United East Indian Company
WpHG:	Wertpapierhandelsgesetz

1

Research framework

1 Prologue/preface

When I started my research for this thesis one of the first things I read was the famous article by Hansmann and Kraakman, 'The End of History for Corporate Law' (2003). Their most exciting analysis of and view on the development of the public corporation as issuer unveiled emerging global characteristics and common regulatory designs of all major financial markets in which a common corporate ideology of shareholder primacy would also emerge, resulting in the 'end of history' of corporate law. Such a common corporate ideology of shareholder primacy would likely press all major jurisdictions towards similar rules of corporate and securities law and practice. Their perspective seems to be based on several assumptions. First, a factual globalization of financial investments by market participants and disappearing borders of the various markets in which they make their investments; secondly, a global convergence of standards for market regulation and investor protection; thirdly, a shared and equally global common ideology on the power of investors ('owners') in public corporations vis-à-vis the board (as their 'agents').[3] The first two were, as far as the European Union (EU) is concerned, supported by the then emerging EU securities regulation, the third was less obvious. They observed a shift from employee and state towards shareholders, but paid less attention to the traditional role of corporate law in the EU as a means of investor protection in 'public' companies. Their perspective therefore seems, at least implicitly, to reflect the clear distinction that can be perceived in US law between *federal* securities law (focussed on market regulation, protection of investors and public oversight) and *state* corporate law (instrumental to the needs of organizing an entrepreneur's business and firmly based on board supremacy and discretion as managers of the firm and its business). This assumption seems to be misunderstood in the EU, where shareholder primacy focuses, in the view of Hansmann and Kraakman, especially to the ends by which the firm should be run, not necessarily to shareholders being in charge of the corporation as 'owners'/'agents'. This, as will be demonstrated, often seems to be misperceived.
It raised my desire to learn how that United States (US) evolutionary perspective would fit into the European developments following the US perspective upon inception of the EU's Financial Services Action Plan (1999) (FSAP) to integrate the EU financial markets by a common ('federal') market regulation, investor protection and the overall introduction of public oversight in the Member States (MS). The FSAP indeed created a common or even 'federal' European framework that, like US securities law, is directed at regulating financial markets and the protection of investors in those markets. This supported the observation of convergence between the US and EU systems; also the wave of emerging corporate governance codes seemed to underscore that analysis, since these were fuelled by corporate scandals of listed companies and growing power of investors and, hence, similarly resulted in principles and 'best practices' to discipline management and protect investors.

3 Hansmann and Kraakman, 'The End of History for Corporate Law', *Yale Law School No. 235,* January 2001, a principal reason, as they state, for convergence is a widespread normative consensus that corporate managers should act exclusively in the economic interests of shareholders, including non-controlling shareholders, Harvard Law School, John M. Olin Center for Law, Economics, and Business, Discussion Paper No. 280.

However the vague notion of 'corporate governance' and the somewhat ambiguous nature of 'non-binding' and 'self-regulatory' codes, seemed to conceal the lack of a clear US-style distinction between the regulatory ends and means of securities regulation and corporate law respectively. It seemed to bypass the border zones with the traditional regulatory role of corporate law in (MS of) the EU to protect investors (shareholders) *by means of corporate law* (often based on 'institutional' ideologies and the so-called 'stakeholder' model[4]). Convergence of securities regulation seemed to go along, at least in the Netherlands, with a certain degree of divergence of the corporate law regime for issuers. After my research in the US, I was puzzled to find the principle of board supremacy and discretion of US (Delaware) issuers still being firmly vested in corporate law and effectively untouched by US securities law, while these same principles for EU issuers came under attack and in some MS were even eroded. How can this phenomenon in the evolutionary process be explained? That question became one of the main drivers for this study.

Almost a decade passed since the publication of the article by Hansmann and Kraakman and history developed partly in the direction they had sketched, but in another way it did not. Global economic developments are changing, as are geopolitics. 'Enronitis' and the recent 'financial crisis' changed the scene as well. It raised many questions, but also raised different rather than 'common' regulatory responses in the US and EU and therefore also my interest in the subject of my thesis: coherence and non-coherence in between securities and corporate law protecting investors/shareholders in a listed public corporation. Limiting myself to a transatlantic comparison, I would like to illustrate this briefly.
In the prevailing dichotomy between US securities and corporate law, the US Congress responded to 'Enronitis' after the burst of the dotcom bubble, primarily by enhancing their prevailing federal securities law disclosure and transparency system for issuers in the primary and secondary market under their Securities Act 1933 (SA'33) and Securities Exchange Act 1934 (SEA'34). The Sarbanes-Oxley Act ('SOx'), subsequent US Securities and Exchange Commission (SEC) regulation and New York Stock Exchange (NYSE) and National Association of Securities Dealers Automated Quotations (NASDAQ) listing rules, enhanced *within that system* the requirements for the quality of market disclosure and the sanctions for non-observance. SOx had only a limited effect on issuers' 'internal affairs': they became obliged to have an audit committee of the board with the power to appoint and compensate as well with the assignment of oversight on the issuer's external auditor and their Chief Executive Officer (CEO) and Chief Financial Officer (CFO) are required to have statutory certification. Some commentators, for example Roberta Romano,[5] observed this to be federal intrusion into state corporate law and contrary to the US Constitution's 'commerce clause' that warrants corporate law to remain in the state's realm. Nevertheless, SOx did not change issuers' basic governance and 'internal affairs'. Delaware, the home state of most issuers, kept to its permissive corporate law principles (default rules), including board supremacy and discretion. Thus investor protection is still mainly provided by federal securities disclo-

4 Wolfgang Schön, 'Corporate disclosure in a Competitive Environment, – The ECJ's Axel Springer Case and the quest for a European Framework for Mandatory Disclosure', *Working Paper No 55 ECGI*, 2006.

5 Roberta Romano, 'The Sarbanes-Oxley Act and the making of Quack Corporate Governance', *NYU, Law and Econ Research Paper 04-032*, 25 September 2004.

sure to market and investors under federal public oversight by the federal SEC and private enforcement (based primarily on the federal securities fraud action). John Coffee Jr. and Dirk Zetzsche, for example, describe this as an outsider system of governance, the shareholders as investor and monitors.[6]

The EU regime for issuers misses the sharp dichotomy between the recent EU federal securities law and Member States' corporate law (embedded in their traditional civil and commercial law but influenced by a series of EU directives). The execution of the FSAP did effectively create a 'federal' EU securities law by adopting a series of directives and regulations on prospectuses (IPO), admission to listing/trading, continuous disclosure and transparency, market abuse, International Financial Reporting Standards (IFRS) and market rules on takeovers.[7] Its design converges in substance with US securities law, albeit that it has been 'translated' and implemented into national law, that public oversight is not exercised by one federal EU agency but by national public agencies (with a certain degree of coordination by Committee of European Securities Regulators (CESR, now ESMA) and that private enforcement also is left to the MS. Nevertheless, this integrated 'federal' EU securities law creates a separate 'European' regulatory layer for EU issuers comparable to the federal securities law in the US. A remarkable and complicating difference with the US remains, however, the overlap with the *corporate* law of Member States. Corporate law for 'public corporations' (a corporate form, like the UK Public Limited Company (PLC), the German "Aktiengesellschaft" (AG), the French "Société Anonyme" (SA) and Dutch "Naamloze Vennootschap" (NV), that allows for tradable shares) traditionally aims at protecting investors (as shareholders), but that is not its exclusive aim. Corporate law in several Member States is also designed to protect the interests of other 'stakeholders', such as creditors and other interested parties, inter alia by means of capital protection, limitations to pay out dividends and – in contrast to the US – by own rules on accounting and disclosure. These systems differ and there is no federal EU corporate law. However a certain degree of harmonization, aiming for protection of 'members' and third parties (arts. 44 and 48 Roman Treaty) under principles of subsidiarity and proportionality, has been achieved by EU directives, e.g. on accounting and disclosure by the 4th and 7th Directives (not exclusively for issuers, but applicable for all 'public' and 'private' corporations).

This overlap between EU securities and national corporate law has various consequences. First, it seems to constrain the evolution of a full-fledged EU securities law, including public oversight and common enforcement mechanism and secondly the consequent further integration of the EU financial markets. Thirdly, it consequently constrains the development of global and/or transatlantic convergence of market rules and investor protection (e.g. United States Generally Accepted Accounting Principles (US GAAP) and IFRS). Fourthly, it may fuel regulatory competition and arbitrage, which of course is not necessarily unfavourable. Fifthly, it tends to further obscure regulatory and judicial responses to new developments

6 Dirk A. Zetzsche, 'Explicit and Implicit system of Corporate Control, a Convergence Theory of Shareholders Rights', *CBC-RPS No. 0001*, 23 September 2004; John C. Coffee Jr., 'The Future as History: The Prospects for Global Convergence in Corporate Governance and its Implications', Columbia Law School Center for Law and Economic Studies Working Paper, 144, 199.

7 The Takeover Directive (2004/25/EC of 21.04.2004) however entails a minimum harmonization with the possibility for the MS to opt out (arts. 9 and 11).

(e.g. Enronitis and shareholders' activism) between securities and corporate law solutions both at the EU and at the national level. This is clearly illustrated by the emergence of a variety of corporate governance codes as a response to both 'Enronitis' and the increasing activism and power of investors. By that time the EU and its MS were in the process of finalizing and/or implementing the new EU securities regulation. In contrast to the US SOx, the responses were not developed by amending the new EU securities law, but rather by changes to existing EU corporate law directives and 'new' recommendations, national corporate law and (differing) 'self-regulatory' corporate governance codes (principles and best practices), partly in the realm of corporate law, such as on Non-Executive Directors (NED) and corporate actions, partly within the scope of securities law (e.g. disclosure items). These codes differ in nature. In the UK, the code is part of the London Stock Exchange (LSE) listing rules, in other countries it is 'annexed' as a reporting requirement (comply or explain) to, and thereby an intrusion of, corporate law. They cover a wide variety of mandatory disclosure items (4^{th}, 7^{th} and art. 10 (substantive disclosure requirements) 13^{th} Dir.) in the management report on, inter alia, board committees, conflicts of interest, drafting and preparing the accounts, audit committees, audit report, internal controls, in control statements, risk factors, strategy discussion and corporate governance of the issuer. These different approaches illustrate the regulatory options and choices that can be and are made. They seem to be caused by different starting conditions of markets and, regulatory traditions and of themselves to cause persistence of overlap and frictions within the existing system of 'EU' and national corporate law and their different dynamics. That evidently may affect not only the ultimate goal of EU market integration, but also, looking from the perspective of individual issuers, their selected governance, following from their incorporation in one of the member states and listing on one of the exchanges (UK partly, linked to listing on LSE), and its exposure to shareholder activism in EU member states and the US.

In hindsight, the first half of the last decade seems to have provided an opportunity for a more distinctive securities law in the EU. Enronitis accelerated the execution of the FSAP and the creation of a new EU cohesive securities regulation. The EU had the option to respond by proper amendments to extend this new body of law *for EU issuers,* e.g. to further requirements on the quality of the reporting process on disclosure documents by issuers (e.g. audit committees, certifications and sanctions), as US Congress did in SOx. The European Commission, however, was still strongly focussing on its aim to create a level playing field within the EU market for corporate control in its draft takeover directive. Also this draft reflects the overlap of corporate and securities law: like the US Williams Act (1968) it provides for market-oriented disclosure and 'traffic' rules for public offers but unlike (specifically) Delaware (allowing the target board in principle 'just to say no' in case of a hostile takeover attempt) the draft directive aimed to severely limit the use of protective devices (break through and board neutrality rules). The High Level Group of Company Law Experts 2002-report was published in the middle of a number of regulatory activities: federalization of securities law and the search for proper answers to further liberalize the EU market for corporate control as well as to discipline management by other means, including corporate law and 'mixed' codes. The report also reflected the diffusion and does not focus primarily on amending the new EU securities regulation (pending and being drafted). Although it strongly advocated disclosure *as a regulatory tool,* its main focus was to eliminate barriers to takeovers to achieve an EU level playing field in the market for corporate control and a series of recommendations on corporate law issues that were not related to issuers and the financial markets. It did not, however, recommend a European corporate governance code. In its response to the Report, the May 2003 Action Plan to modernize and improve EU corporate law and governance, the European Commission similarly did not focus on amending and/or extending its pending and proposed securities regulation for issuers, but rather continued to follow its traditional corporate law-oriented route. It explicitly preserved the *acquis communautaire*,[8] did not fully endorse the High Level Group's (HLG) claim of superiority of disclosure over substantive regulation, refrained from an EU Corporate Governance Code, published recommendations on non executive directors and executive remuneration, amended the 4th and 7th Directives to require *issuers* to make a 'comply or explain' disclosure on applicable corporate governance codes, strengthened by amendment of the 8th Directive the external auditor's position not only for issuers but for all corporations 'of public interest' and initiated a directive to enhance shareholders' rights. These amendments seem to be partly inspired by the LLSV study by Shleifer and Vishny.[9]

These EU regulatory responses seem to illustrate that the EU did not strengthen its new securities regulation under way, but rather returned – at least in part – to its earlier practice of protecting investors by corporate rather than securities law, although the draft 5th Directive,[10] attempting to harmonize the complete internal affairs of all 'public corporations' (note: *not* issuers), by mandatory division of powers between management, supervisors (non executive directors) and the GMS, was withdrawn in 2004[11], because of disagreement on labour participation, and the final Statute on European Company (SE) refers the internal

8 As the EU states: "the Community *acquis* is the body of common rights and obligations which bind all the Member States together within the European Union. It is constantly evolving and comprises: a) the content, principles and political objectives of the Treaties; b) the legislation adopted in application of the treaties and the case law of the Court of Justice; c) the declarations and resolutions adopted by the Union; d) measures relating to the common foreign and security policy; e) measures relating to justice and home affairs; f) international agreements concluded by the Community and those concluded by the Member States between themselves in the field of the Union's activities." Thus the Community *acquis* comprises not only Community law in the strict sense, but also all acts adopted under the second and third pillars of the European Union and the common objectives laid down in the Treaties. The Union has committed itself to maintaining the Community *acquis* in its entirety and developing it further. Applicant countries have to accept the Community *acquis* before they can join the Union. Derogations from the *acquis* are granted only in exceptional circumstances and are limited in scope. To integrate into the European Union, applicant countries will have to transpose the *acquis* into their national legislation and implement it from the moment of their accession. See for more information <http://europa.eu/scadplus/glossary/community_acquis_en.htm>.

9 R. La Porta, F. Lopez de Silanes, A. Shleifer and R.W. Vishny, *Law and Finance*, NBER Working Paper, w566, 1999.

10 COM (72) 887 final, 18 July 1972, JO C 131/49; EC Bull Supp 10/72. First draft 1972. Last official draft: COM (91) 372 final, 20 November 1991; (1991) OJ C321/9. In 1996, the Commission asked Ernst & Young to consider the relevance of the Draft Fifth Directive in the study it had commissioned on corporate governance. The Commission decided to draw back the proposal on 9 January 2004, OJ C 5/20 (2004), Vanessa Edwards, *EC Company Law*, New York: Oxford University Press 1999, p. 389. Two highly controversial proposals were the mandatory creation of a two-tier board structure (Art. 2 Fifth Directive) consisting of a managing organ and a supervisory organ and mandatory provisions for employees' representation on the supervisory board for companies with a workforce greater than 500, art. 4(2)(3). See Vanessa Edwards, *EC Company Law*, New York: Oxford University Press 1999, p. 388.

11 Cf. the famous debate on the 'race to the bottom' initiated by Professor Winter in 1964.

affairs to the jurisdiction in which an SE is created. The recent directive (2006) on strengthening corporate law rights of shareholders as 'members' is not inspired by US law, not market-oriented and not focussed on improving investor protection, but rather on strengthening the position of shareholders in the corporation by amending corporate rather than EU securities regulation. It again seems to reflect the 'institutional' stakeholder concept of EU corporate law directives and that of various MS to divide powers in the internal affairs of the 'public'-type corporation, *irrespective* of its submission to the financial market and securities regulation as an *issuer*. This confusion, caused by a lack of clear regulatory notions and descriptions, also confuses responses to new developments. Different economic market structures, market liquidity,[12] shareholder base,[13] regulation, traditions and interest groups,[14] may help to explain the different starting conditions in the US, EU and its Member States. (This is not the aim of this study.)

But it cannot explain why EU securities regulation still seems to lack the nature of a market-oriented standalone character under public oversight and with its own enforcement mechanisms without direct interference with and relation to an issuer's 'internal affairs' according to the selected corporate law of Member States; this US dichotomy is lacking. My hypothesis is that such dichotomy is needed to enable proper analysis and guidance both at EU and Member State level implementing, absorbing and enforcing (new) rules for investor protection and by that to contribute to a consistent regulatory system needed in its further development: globalization of markets and reaction to new circumstances and developments: e.g., entrance of 'new' players like State Wealth Funds and hedge funds, new financial instruments and techniques like stock lending and empty voting, mergers of stock exchanges, creation of new market platforms (Multilateral Trading Facilities' MTF), other techniques to acquire control of issuers next to a takeover or proxy fights, development in

12 The US securities markets were already very liquid (cf. John Armour and David A. Skeel, 'Who Writes the Rules for Hostile Takeovers, and Why? The Peculiar Divergences of US and UK Takeover Regulation', *ECGI Law Working Paper No. 73,* 2006) the beginning of the 20th century and investments by the public far more dispersed as illustrated in the famous Berle & Means analysis (1932): corporations characterized by a separation of ownership from control. The securities markets were already severely regulated by the New Deal federal securities acts of '33 and '34, leading to extensive disclosure obligations for listed and traded corporations and underpinned by strong public oversight, regulatory and enforcement powers of the SEC and private enforcement based primarily on the § 10b and Rule 10-b SEA '34 federal securities fraud action. Notably no cooperation between shareholders was allowed, this contributed to the dispersion of shareholders. Also technology, economics and politics played their role. The UK with its market system, dispersed shareholders and traditionally strong protection of investors also in takeover situation, takes a different position.

13 See among others John C. Coffee, 'The Future as History: The Prospects for Global Convergence in Corporate Governance and its Implications', *Columbia Law School Center for Law and Economic Studies Working Paper No. 144*, February 1999, also Mark J. Roe, *Strong Managers, Weak Owners: The Political Roots of American Corporate Finance,* Princeton, New Jersey: Princeton University Press 1994, But also Shleifer, Vihsny, LLSV.

14 There exists a vast amount of literature in the question of why investor protection differs between the US and Europe, see also D. Donald, 'Approaching Comparative Company Law', *Institute for Law and Finance (ILF) Working paper series no. 77,* 12 February 2008, for critique on the so-called Origin Theorist, Lopez, Shleifer etc. and their theory that the pre-supposed weak form of investor protection in continental Europe correlates to civil law origin of most of the European countries compared to strong investor protection in the UK and US correlating to their common law origin.

law suits that support shareholder and again, last but not least, the internal organization and governance model of issuers.

This brings me back to Hansmann and Kraakman's 'The End of Corporate History' and the market-oriented model of issuers, heavily inspired through law and economics principle-agency theory, that they described from a US perspective, but with the claim of having global value in a globalizing world. The idea fascinated me right from the start of my research. I started by making a comparative analysis of the basic elements and characteristics of the US and EU standalone body of securities law, its federal character and the system of public and private enforcement. Full disclosure to inform the market and investors in the issuer's securities is a key element in both systems and their substantive rules are quite similar. The federal US system for the US market as a whole, however, really stands alone since it remains addressed to the issuer as such, does not interfere with the freedom to elect and design his corporate form and governance, and is 'complete' in substance as well as in enforcement: it includes traffic rules for takeover bids and federal rules for proxy solicitation, but also provides for its own federal public oversight (SEC), rule-making and enforcement as well as for federal actions for private enforcement. This clear dichotomy between federal securities and state corporate law from a regulatory perspective allows for continuous focus on market-related issues in its development. At the same time it allows issuers that want to raise finance in the market and thereby accept exposing themselves to the federal securities law to select the jurisdiction of incorporation and design their internal affairs and governance to organize their business without any interference from 'federal' corporate law, notwithstanding the influence of the Model Business Corporation Act (MBCA) on state corporate law and the dominance of Delaware law in the regulatory competition within the US.

This very brief summary may be too simple, but still allows it to be contrasted with the EU (also as an analytical tool). The dominance of the new 'federal' EU securities law is less strong and the dichotomy of corporate law both at EU and even more on state level is less sharp, even confused. At EU level it constrains public enforcement since there is no federal public agency and private enforcement since EU law does not provide for such federal action. Implementation by member states requires this dichotomy too and similarly may be confused by the lack of a sharp distinctive dichotomy not only in so far as the EU law itself conceals the overlap between its securities law and *acquis communautaire* in corporate law, but also of the traditional overlap in the various member countries with corporate, commercial and civil law 'solutions' for problems that securities law may or should address from its aims to regulate financial markets and to protect investors. Investors often remain seen as 'shareholders' or 'members' in the first place and hence their protection is, at least, sought in corporate law. In the turmoil of subsequent crises in the last decade has a serious regulatory competition and/or arbitrage by issuers has so far not seemed to emerge. Economic and financial considerations (such as market liquidity and professionality) will remain the primary drivers for selection of the 'regulated market' within the EU in which the issuer wants to raise finance by issuing securities. But the impact for the issuer of thus being exposed to the securities law regime on the governance and internal affairs of their selected jurisdiction and the basic position of the board and its supremacy and discretion vis-à-vis its investors, may differ substantially in comparison to the US but also within the EU. A few examples may illustrate this case.

Closer analysis of disclosure rules as a cornerstone of securities law shows that the standalone mandatory disclosure of the annual accounts, including the management report, under the Transparency Directive, in various Member States remains closely connected with corporate law 'accounting' (and indirectly with possible liability) by the board to the General Meeting of Shareholders (GMS) as a body corporate within the issuer's internal organization. In the Netherlands the GMS shall even adopt the accounts which overlap with the Netherlands Authority Financial Markets (AFM)'s public oversight and power to require restatements. The management report, which for issuers is part of their disclosure document, shall contain statements on compliance with corporate governance codes, but these also aim to enhance the position of shareholders *in meeting*. What are the basic regulatory aims, borderlines and conceptual overlaps of and between corporate and securities law? What are the differences with Delaware, the UK and Germany? Do codes result in quasi by-laws or enforceable securities regulation?[15] Does mandatory disclosure on compliance with 'principles & best practices' of corporate governance codes thus intrude the issuers' internal affairs? Are 'shareholder orientation' and 'shareholder democracy' proper means to drive the regulatory agenda? And does the rather vague concept of shareholders as 'owners' of the corporation and 'principals' (agency theory), also in view of the differences between jurisdictions[16] (including block and dispersed sharebase!), provide clear guidance for regulatory reform? Does the mere concept of 'corporate governance' provide a clear notion in a global or even transatlantic perspective? How to prevent 'misguided' accumulation of traditional corporate law responses caused by not properly taking into account the basic market-oriented approach that results from the new EU 'federal' securities regulation be prevented. What are the consequences for *private* enforcement and exposure to the recent wave of shareholder's activism? Will the target board's supremacy and discretion be upheld in an attempt to acquire full or effective control on the borderlines between corporate and securities law?
All these questions are closely interrelated and therefore easy answers are not available. They seem, however, to be indispensable in order to understand the system and its dynamics and as an analytical framework to enable assessment of existing and future regulation. How and to what extent does this study address these questions?

2 The structure and aims of this study

The main purpose of this study is to contribute to the analytical framework for regulators and issuers to understand the scope, consistency and standalone character of the new EU securities regulation in comparison to the US system as well as the impact of 'going/being

15 See chapter 4 where it will be demonstrated that the Netherlands Enterprise Chamber under the investigation procedure (arts. 2:344-359 NCC) has extensively explained these corporate governance rules and under the umbrella of art. 2:8 NCC (reasonableness and fairness) these rules became a sort of customary law.

16 See for example: John C. Coffee Jr., 'The Future as History: The Prospects for Global Convergence in Corporate Governance and its Implications', *Columbia Law School Center for Law and Economic Studies Working Paper No. 144*, February 1999.

public' on the internal affairs and governance of issuers under their selected jurisdiction (securities regulation, listing rules, corporate law, corporate governance codes, their charter and bylaws). Issuers are defined as public corporations whose shares are traded on regulated markets, as defined by European law, see art. 4 (1) No. 14 of Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments (MIFID). Going public will expose the issuer to a new and extra layer of securities disclosure and listing rules besides 'internal affairs' rules of corporate law and, as a consequence of going public, also corporate governance. This study aims to contribute to a comparative understanding of the subsequent interaction of securities and corporate law.
Testing the following hypothesis will contribute to this aim. My hypothesis is that a (US) dichotomy between aims, nature and scope of securities and corporate law is needed to enable proper analysis and guidance both at EU and Member State level implementing, absorbing and enforcing (new) rules for investor protection and by that to contribute to a consistent regulatory system needed in its further development and reaction to new circumstances: globalization of markets, entrance of new players like State Wealth Funds and hedge funds, new financial instruments and techniques like stock lending and empty voting, mergers of stock exchanges, creation of new market platforms (MTF), other techniques to acquire control of issuers alongside a takeover or proxy fight, development in suits that support shareholder and again, last but not least, the organization and governance model of issuers.
The implementation of the new EU securities rules is almost completed and the EU sources of law and their regulatory aims and principles therefore will tend to disappear behind the law of Member States. These aims and principles should be withheld to guide future EU and national developments in the financial markets, corporate practice, public oversight and enforcement and to continuously alert regulators to possible risks of diffusion with (national) corporate law and corporate governance codes to guide further evolution of 'federal' EU securities law to underscore the integration of a common EU financial market.[17]
This requires identification and analysis of overlapping rules and guidance for coherent, unambiguous securities and corporate rules regulating the listed public corporation. It also requires, on the other hand, similar analysis of company law insofar as issuers are involved. So far clear regulatory distinctions do not seem to have guided securities and corporate law (internal affairs) objectives. These, as illustrated, 'mixed' regulatory responses to corporate scandals and simultaneous introduction of the EU securities regulation, as well as governance codes, may result in different degrees of exposure to shareholders' activism, also in judicial review of board conduct effecting its power to determine strategy and policies and especially in case of a takeover or pressure to change strategy. The board's position in several EU jurisdictions seems to be less clear in the perspective of our ability to assess the regulatory aims: enhancing market integrity and proper monitoring mechanisms, against the impact on the effective direction and management of issuers, which boils down to the principle of board supremacy. This affects the choices to be made by public companies on 'external' statutory rules or codes of best practice that should or could find their way into

17 As will be demonstrated in chapter 2 the implementation of the EU securities disclosure system results in a similar US securities disclosure system aiming for investor protection by disclosure.

the company's articles of associations (or bylaws) and the impact thereof on their enforcement.

Public corporations remain major engines of our economy and the community at large. A coherent system of corporate and securities law will contribute to market confidence that is indispensable in order to finance their activities through the issue of securities.[18] The EU and Member States are increasingly intertwined with international and global financial markets. A highly professional and trustworthy integrated EU capital market is key to its future. The fact that many European companies are listed in the EU as well as in the US underpins the relevance of this study.[19] These firms have to comply with overlapping and often contradictory rules and regulations. A proper understanding of commonalities and differences thereof is highly relevant. The same is true for their advisors and the securities industry in general (merchant bankers, lawyers, accountants etc.). The operation of these public companies also depends on the transparency of that legal framework in which they operate and have to comply with. Continuous discussions between the US and the EU on exemptions and/or extensions to avoid inefficient overlaps of otherwise cumulatively applicable rules remain important. Comparison of the basic structure of US and EU securities and corporate law, especially with regard to its regulatory aims, means and enforcement, is needed.

2.1 Disclosure and accounting

Disclosure of information by issuers to the market is the hardcore of US securities law. It is the basic regulatory response to the moral hazards of promoters and issuers as perceived in the public corporation.[20] The new EU securities law essentially adopts that same starting point, but, as stated above, still seems to interfere with corporate law concepts of accounting by the board to its GMS. My hypothesis for chapter 2 is that, exploring and comparing in more detail the first layer of investor protection as provided for by US and EU securities law, US securities law essentially provides a standalone character of initial and continuous disclosure and in comparison the EU (with mutual difference between the examined Member States) a somewhat mixed character of EU regulation that remains linked to some extent to corporate law and that in the EU and examined Member States, especially in the Netherlands, this overlap and frictions of the securities disclosure systems as implemented in the Member States with the existing national system of corporate law is the result. This chapter therefore explores from the perspective of the US and EU financial market regulation and securities law, the requirements for issuers and the question of whether and to what extent (the regulatory aims of) such regulation affect the internal affairs and governance of issuers upon going and being public. Chapter 2 will explore that central disclosure philosophy in the new EU securities regulation in comparison to the US. It aims at a comparative analysis of

18 Bernard S. Black, 'The Legal and Institutional Preconditions for Strong Securities Markets', *UCLA Law Review*, Vol. 48, pp. 781-856, 2001.

19 Approximately 40 Netherlands companies are listed at one of the American exchanges.

20 John C. Coffee Jr., The Future as History: The Prospects for Global Convergence in Corporate Governance and its implications, Columbia Law School Center for Law and Economics Studies working Paper, no. 144, 1999: stating that state law compared to securities law is indifferent as to the regulation of the public corporation. Cf also Paul Mahoney.

the major elements of the US and EU disclosure and accounting systems with the resulting regulation of some Member States (UK, Germany, the Netherlands). Post-FSA EU securities regulation and starting conditions are seemingly of major influence on the results of this comparison. Similarly regulatory overlap and frictions in the borderline between securities and corporate law in the several systems will be explored.

Par. 2.1 will first summarize the new EU securities regulation as it emerged from the Financial Services Action Plan (1999) and, accelerated by the post-Enron momentum, was quickly adopted as a coherent securities law covering initial and continuous disclosure of issuers under public oversight: Prospectus Directive and regulations (2003), Directive on Admission to Official Stock Exchange Listing (2003), Transparency Directive (2004), Market Abuse Directive(s) (2003) and the IAS Regulations (2002) introducing IFRS as accounting standards for issuer's *consolidated* accounts, also by amendments for issuers of the 4th and 7th Directives (2006) and the revised 8th Directive on statutory auditors (2006). Disclosure rules cover insider trading, major holdings, intermediate price sensitive information and periodical reports, but the core remains the issuer's annual financial report (annual accounts, management report and a certification of its responsible persons that these provide a true and fair view). To allow their comparability and standardization, the issuer's *consolidated* accounts shall be drafted in accordance with IFRS. Like the US Report to Shareholders (10K-20F) this annual financial report effectively serves as a standalone market- and investor-oriented disclosure document.

Par. 2.2 will elaborate on the concepts of securities law disclosure and corporate law accounting. For the US, the federal securities regulation Securities Act 1933 (SA'33) and Securities Exchange Act 1934 (SEA'34), SEC's Rules and listing rules will be examined, in corporate law the Revised MBCA that was of major influence in the convergence of states' company laws and Delaware state corporate law and case law of the Delaware Chancery and Supreme Court as representative of the most elaborated corporate law will be analyzed. Par. 2.3 will first summarize the stakeholders-oriented EU system of the 1st, 4th and 7th Directives and par. 2.4 will summarize and compare the key elements of the US market-oriented disclosure system. Par. 2.5 will analyze the regulation of annual accounts of issuers as disclosure document and accounting to shareholders.

In their annual report, EU issuers shall state whether they comply with the applicable national corporate governance code. These codes seem to interfere with EU securities regulation, covering a wide range of best practices for issuers on reporting items in issuers' annual reports on, inter alia, board committees and conflicts of interest, but also on issues directly linked to drafting and preparing the accounts (role of audit committees, audit report, internal controls, in control statements, risk factors, strategy discussion, etc.) The US did not witness such a proliferation of 'self-regulatory' corporate governance best practices and disclosure items. US Congress merely enhanced the prevailing US securities regulation and its disclosure rules (SOx/SEC-Rules, listing rules).

Thus the EU securities disclosure regulation results in a 'federal' standalone set of rules under national public oversight. However, unlike in the US, these European securities law rules also build on and remain connected with the parallel and still prevailing *corporate* law accounting and disclosure rules of the 1st, 4th and 7th *company* law Directives that apply to *all* (close *and* publicly held) *companies.* These provide mandatory stakeholder-oriented rules for single and consolidated accounts with own accounting, audit and 'disclosure' rules. They

apply also to the single accounts of issuers. So, issuers *shall* apply IFRS in their *consolidated* accounts, but Member States may allow – as many did – these to be applied in the issuer's single ('legal') accounts. The latter, however, remain connected to the stakeholder-oriented national *corporate* law with the emphasis on creditor/shareholder protection rather than market transparency and investor protection.
Par. 2.6 will subsequently deal with public oversight of annual reports and their enforcement including the application and interpretation of IFRS. Par. 2.7 will discuss means for private enforcement. Being left to the Member States, public and private enforcement of these combined and entangled new rules reveal remarkable differences. The way in which Member States created enforcement mechanisms, including causes of action to allow litigation in court, show important differences that may over time affect the evolution of common market principles. These differences will be compared in more detail against the background of the aims of an integrated EU financial market.

2.2 Investor protection in corporate law: shareholders rights and board supremacy in the 'internal affairs' of issuers

This paragraph will explore in more detail the (statutory) division of (collective and individual) powers of investors (GMS) and the board/SB and, hence, both the nature of protection thus provided to investors (as shareholders) and the statutory level and extent of board supremacy, taking into account recent developments that have affected the prevailing systems.
My hypothesis is that convergence of securities regulation seems to go along with a certain degree of divergence of the corporate law regime for issuers in the examined systems as related to the division of powers between the board (BoM/SB) and the GMS and (groups of) individual shareholders. Especially if focussed on the supremacy of the board, GMS's rights as such and shareholder's procedural rights seemingly led to a stronger position in the organizational design of the issuer in the Netherlands than in the other examined systems. As will be demonstrated in chapter 4, the Netherlands right of inquiry (arts. 2:344-359) led to erosion of the supremacy and discretion of the Netherlands Board (BoM/SB) in a listed public corporation. This seems however to be concealed by the international header of corporate governance and resulting principles and 'best practices' to discipline management and protect investors. They also conceal the lack of clear US-style distinction between the regulatory ends and means of securities regulation and corporate law respectively. It seems to bypass the traditional regulatory role of corporate law in (Member States of) the EU to protect investors (shareholders) *by means of corporate law* (often based on 'institutional' and the so-called 'stakeholder' model). This hypothesis will be tested in chapter 3.
Thus although the securities law did converge, the question remains as to how the 'federal' EU securities law with its main goal of investor protection interacts with internal affairs of EU issuers in general and, more specifically, their (degree of) 'board supremacy'[21] in discharging its assignment of directing the issuers entrepreneurial policies and activities and managing the firm's organization and operations. And: whether this new system can play a

21 This principle was firmly vested in e.g. German (1937 Führer-prinzip) and Netherlands law (Forumbank).

guiding role for new regulation to focus on investor protection by means of disclosure and transparency in *EU* securities regulation, rather than by means of corporate law. From the perspective of issuers, that analysis may reveal that securities regulation is converging, but still differs insofar as it remains linked to corporate law and that different regimes for the issuer's internal affairs may influence their choice of jurisdiction and financial market to issue and have traded their securities.[22]

The comparison outlined above may, first, contribute to a better understanding of the broad regulatory process as such in the field of protecting both investors in financial markets and firms that 'go public' by issuing shares in those markets. More particularly: a proper demarcation (or as the case may be: overlap) between the ends and means of both securities and corporate law to allow more precise regulatory impact assessment (including 'self-regulation' by corporate governance codes and delegated regulation). Evidently (public/private) enforcement is a key element (this will be the topic of chapter 4).

Secondly, it thus may improve conceptualization of the basics of securities law and its public and private enforcement and to elaborate (common) principles of market integrity and issuer's integrity in the market.

Thirdly, it may allow a better understanding of initial regulation and subsequent assessment of the impact thereof on the corporate statute of issuers upon going and being 'public'.

Fourthly, for investors it may facilitate assessment of differences and commonalities of markets and issuers in those markets, more specifically their 'shareholders powers'.

Fifthly, for issuers it may allow a better (comparative) assessment of the impact of securities and corporate law (including codes) upon going and being public on the dissemination of powers between investors and the board, and (the degree of) 'board supremacy'[23] in its internal organization, corporate causes of actions for investors to enforce their rights (as will be elaborated in chapter 4). Such assessment may allow a well-considered choice of both the issuer's seat and the market in which securities will be issued. Evidently the result of that analysis may reveal that securities regulation may no longer show great differences but that different regimes for the issuer's internal affairs may influence, inter alia their choice of jurisdiction.[24]

These comparisons will reveal remarkable differences between the US and EU. Investor protection in the US remains vested in securities law, primarily by market disclosure. SOx did not change that and rather enhanced the quality requirements of financial disclosure,[25] guided by the necessity to maintain and enhance integrity in the securities markets and fairness to investors.[26] In corporate law, board supremacy remains the primary standard,

22 Luca Enriques & Tobias H. Troeger, 'Issuer choice in Europe', *ECGI-Law Working Paper No. 90/2007,* July 2008; Roberta Romano, 'The Sarbanes-Oxley Act and the making of Quack Corporate Governance', *NYU, Law and Econ Research Paper 04-032*, September 25, 2004.

23 This principle was i.e. firmly vested in e.g. German (1937 Führer-prinzip) and Netherlands law (Forum-bank),

24 Luca Enriques & Tobias H. Troeger, 'Issuer choice in Europe', *ECGI-Law Working Paper No. 90/2007,* July 2008; Roberta Romano, 'The Sarbanes-Oxley Act and the making of Quack Corporate Governance', *NYU, Law and Econ Research Paper 04-032*, September 25, 2004.

25 Raaijmakers 2006, p. 320.

26 ABA-study on listing standards and corporate governance, p. 64, A US study on listing standards and corporate governance states in 2002 that corporate governance codes of different kinds have proliferated throughout the world. Many of them are comprehensive. However, the best practice guidelines

upheld by the US judiciary, in the internal organization ('internal affairs') of US issuers. It has not changed fundamentally, has survived recent shareholder activism and also allows the board to defend the target in a control transaction. It illustrates that markets matter, as does law.

In the EU, regulatory action is seen to be fragmented over corporate and securities law by different regulatory instruments: amendments to prevailing EU *corporate law* directives and recommendations, and at the level of Member States: amendments to corporate law (including strengthening shareholder rights), 'self-regulatory' corporate governance entailing a mix of corporate and securities law with different nature and status.[27] Thus the post-FSA securities rules were exposed in the Member States to 'path-dependant' differences of their national systems of checks and balances between investors and the firm traditionally (continental EU insider system) largely governed in *corporate* rather than in their *securities* law, which is emerging slowly and at a different speed.

The US-EU comparison reveals – too briefly – that US Congress stuck to the basic structure of the '33 and '34 Acts and enhancement thereof by the SOx, while the EU still were in the process of executing the FSA agenda introducing a 'federal' EU securities regulation. It suggests that EU issuers have been more exposed to shareholder's activism, especially in takeover fights and pressure on the firm's strategy.

Par. 3.1 will further analyze the claim of Kraakman and Hansmann concerning the dominance of the corporate ideology of shareholder primacy leading towards major jurisdictions adopting similar rules of corporate law and practice and further elaborate the context of the aforementioned hypothesis.

Par. 3.2 will elaborate the theoretical concepts underlying the corporate form and corporate governance (agency theory), also in view of changing market structures and market for corporate control. This allows a better understanding of commonalities and differences between the US and EU and some of its Member States, particularly the impact of regulatory responses to corporate scandals and shareholder activism and its effect on issuers' governance and board supremacy.

Par. 3.3 will compare the statutory division of powers in listed public corporations. The basic GMS powers and (groups of) investors with respect to the issuer's governance and corporate structure (division of powers between board and GMS/shareholders) will be examined, including recent changes. A detailed analysis is given in the annexes.

contemplated by their proposal should be limited to the corporate governance areas that are necessary for and directly relevant to maintenance of integrity in the securities markets and fairness to investors. In light of recent widely published corporate failures, the issue of defining the most effective approach to improving corporate governance as it affects markets is squarely presented at this time. It is not necessary or even desirable to redesign the current system to achieve ongoing improvement in the process. Improvement should be built on the strengths of the existing system. Any significant change in the system creates the potential of new risks to the capital markets, issuers and investors, and should only be established after careful and focussed study. Any systemic change should take into account the role of state corporate law in governance, corporate governance codes and practices and the appropriate areas of concern to and interest of the exchanges.

27 See for example the UK through combined code applicable through the listing rules and the Dutch Corporate Governance Code (DCGC) applicable through corporate governance statement ('comply or explain') in the Management Report (now also mandatory cause of amendment § 46b 4th Directive).

Par. 3.4.will provide a short overview and comparison of group and individual rights of shareholders, mainly focussed on shareholder rights pre-meeting, with the other jurisdictions related to the division of powers between the board and the shareholders: the primacy of the board. The level of influence of the shareholders in the company (board supremacy) is, alongside the substantive rights of the shareholders, partly determined by these procedural rules related to convocation of a meeting and setting the agenda for the meeting. Par. 3.5 will draw some preliminary conclusions and par. 3.6 will analyze the bundling of voting power and explore if, how and on at what level (corporate or securities law) legal regimes have developed and are facilitating mechanism and rules on proxy voting that may influence the division of power within the corporation. In par. 3.6 proxy solicitation and voting will be analyzed. Par. 3.7 will summarize chapter 3.

2.3 Board supremacy and discretion in the context of investor's actions: the Netherlands right of inquiry as unique action for activist shareholders

The HLG in 2002, in its report for modernizing company law in the EU, advised providing shareholders with the right to apply to a court or appropriate administrative body to order a special investigation. A European framework rule should be adopted to this end (Recommendation III.8). The HLG places its proposal for an investigation procedure in the context of strengthening (minority) shareholders' rights and their monitoring role as 'principal'. The HLG seemingly did not take into account the already evolving EU securities disclosure system under which issuers are required to provide investors with information on an annual and interim basis and does not make a distinction between listed public and closed companies and states. The EC in its Action Plan 2003 for the Medium Term proposed enhancing the responsibilities of board members by a special investigation right, wrongful trading rule, and director's disqualification. However, the EC did not clarify its proposal. In chapter 4 it will be demonstrated that the HLG's proposal of 2002 to introduce an investigation procedure, in which the Netherlands have already gained experience over 40 years, at EU level does seem a good idea. This investigation by its nature is at odds with the securities disclosure system and with corporate law for (listed) public corporations. The analysis of chapter 4 also leads to the conclusion that Netherlands Right of Inquiry should be re-examined.

As analyzed in chapter 2, investor protection in the US as well as in the EU is primarily based on securities law disclosure, public oversight and enforcement both in the primary market (IPO) by prospectus liability and in the secondary market by securities fraud. The second layer of investor protection is found in US, UK and German derivative suits, albeit under the protection of the BJR and hence focussing on its limits, i.e. breaches of fiduciary duties.[28] US (Delaware) and German law firmly vest the principles of board supremacy and discretion. These are upheld in court when business decisions of the board are challenged in claims for damages and rescinding business decision. The BJR protects the board by procedural

28 a) Protection of shareholders, as especially provided for by EU continental systems, is also found in the possibility to annul decisions of the bodies corporate within the issuer's organization. It can be considered as the bolt on GMS decision making and in that sense as protection against abuse by the majority. Also decisions of organs other than the board can be rescinded, e.g. 2:15 NCC. However in the Netherlands, it is very rarely used as such in the case of issuers since the same or similar results can be reached in an investigation procedure.

requirements but also, more importantly, by the basic assumption of supremacy and discretion of the board. This may be set aside if the claimant – in a derivative suit – can prove a breach of fiduciary duties of the board vis-à-vis the corporation.

A comparative analysis on this issue reveals a remarkable difference of Netherlands law, both regarding the basic rule on directors' liability, but more fundamentally with respect to the impact on the board's discretion of the case law under its investigation procedure. Board members may be held liable through an art. 2:9 NCC procedure, but not derivatively. As stated above no BJR-rule will protect the board (members), although the standard used in *that* particular (but for issuers extremely unusual) procedure would presumably not differ substantially from the US, Germany and the UK since the judicial standard is rather high. The judicial assessment, however, does not start – as the BJR does – with a 'free zone' starting from its basic assumption of discretionary business judgment. Thus it lacks the certainty of the BJR-approach.

The more remarkable difference, however, is created by Netherlands' investigation procedure, which is unique and does not exist in the US, at EU level or in the UK and Germany. The procedure is enacted in NCC Book 2, chapter 8 (arts. 2:344-2:359). The competent court is the Enterprise Chamber of the Amsterdam Court of Appeal.[29] It provides shareholders[30] with two successive rights in respect of a corporation (including issuers as well as private limited companies). First, shareholders (owning 10% of the shares or shares representing an nominal value of EUR 225,000) are entitled to petition for an investigation to be ordered in case there are well-founded reasons to doubt proper ('juist') administration ('beleid') of the corporation, and – if the court so finds – appoint one or more investigators to investigate the administration and course of affairs of the corporation (during a certain period). Secondly, based upon the report of the investigator(s) they may request the court to establish that this constitutes mismanagement ('wanbeleid'), and order specific injunctions, including dismissal and appointment of new directors.[31] Otherwise the court may grant injunctive relief (art. 2:349a NCC) during the whole procedure if the court finds that the state of affairs so require. Over the last decade, as will be set out below, this procedure and the possibility for (immediate) injunctive relief has turned the investigation procedure into a strong weapon for investors and activist shareholders to challenge the board's supremacy

29 Cornelis de Groot, *Corporate Governance as a Limited Legal Concept*, Kluwer Law International: Netherlands 2009, p. 34, technically, the Chamber of Business is a division of the Court of appeals at Amsterdam (one of the five Courts of Appeal in the Netherlands). Although part of the Court of Appeal at Amsterdam, the Chamber of Business acts as the court of first instance under the provisions on the right of inquiry. The aforementioned book gives an extensive overview of this investigation procedure in the Netherlands. For some other English articles on this investigation procedure see: M. Josephus Jitta et al., *The Companies and Business Court from a Comparative Law Perspective* (Deventer: Kluwer, 2004); J.B. Jacobs, 'The Role of Specialized Courts Resolving Corporate Governance Disputes in the United states and in the EU: An American Judge's Perspective', *Ondernemingsrecht* (2007), 80-85; M.J. Kroeze, 'The Companies and Business Court as a Specialized Court', *Ondernemingsrecht* (2007), 86-91; L. Timmerman, 'Company Law and the Dutch Supreme Court', *Ondernemingsrecht* (2007), 91-95. See also the article of Erik P.M. Vermeulen & Dirk A. Zetzsche , 'The Use and Abuse of Investor Suits', *TILEC Discussion Paper, DP 2010-001*, January 2010, for interesting comparative research into German rescission suit and the Netherlands investigation procedure.

30 And holders of depository rights.

31 Cornelis de Groot, *Corporate Governance as a Limited Legal Concept*, Kluwer Law International: Netherlands 2009, p. 34, see this book for an extensive overview of this procedure.

and discretion and thus 'provoke' a judicial review of its strategy, policies and actions. This procedure effectively evolved towards a quasi-derivative suit, at least to the extent that preliminary judgment may be acquired as to 'misconduct' of the board which can be used in a subsequent liability suit. Anyhow, this evidently provides claimants 'leverage' in subsequent settlement negotiations. In a comparative perspective, the most remarkable element of the investigation procedure is that it allows an almost unlimited judicial review board action, in sharp contrast to the BJR-approach.

Meanwhile, this procedure almost completely absolved the 'classical' action to annul (former) decisions/resolutions of the GMS (supervisory) board.

My next hypothesis is that board supremacy and discretion of the board of Netherlands issuers has been remarkably eroded over the last decade (being re-established only very recently by the Supreme Court), due to the fact that this investigation procedure has not been the subject of a fundamental review in the total change of the regulatory landscape for issuers and remained a corporate law procedure not taking into account the fundamental change in securities law.[32] This investigation procedure and its declared, but seemingly outdated, purposes will be tested and contrasted to the separate 'layers' of investor's protection offered by the completely revised EU and Netherlands securities regulation, again in comparison with the US, EU, UK and Germany. Again I may advise the reader to compare the tables provided in the annexes.

Chapter 5. will make some closing and synthesizing observations on issuers as addresse of (self-) regulation, public oversight, judicial review and private enforcement in between securities and corporate law.

3 Methodology

This research entails a basic understanding of commonalities and differences in the field of corporate and securities law. It will be conducted by a comparative functional[33] analysis of the major elements of the US and EU securities and corporate/accounting law systems and the resulting regulation of some Member States (UK, Germany and the Netherlands).

32 Of course the Supreme Court in ABN-AMRO and AMSI reconfirmed the supremacy and discretion of the Netherlands board (BoM/SB), nonetheless the procedural structure of the investigation procedure almost automatically leads to substantial board review.

33 The comparison will be functional: 'The basic methodogical principle of all comparative law is that of functionality. From this basic principle stem all the other rules which determine the choice of laws to compare, the scope of the undertaking, the creation of a system of comparative law, and so on. Incomparable cannot usefully be compared, and in law the only things which are comparable are those which fulfil the same function.' K. Zweigert & H. Kotz, translated by Tony Weir, *An introduction to Comparative Law (third edition),* Oxford: Clarendon Press 1998. See also Reinier R. Kraakman, Paul Davies, Henry Hansmann, Gerard Hertig, Klaus J. Hopt, Hideki Kanda & Edward B. Rock, *The Anatomy of Corporate Law, A Comparative and Functional Approach*, New York: Oxford University Press 2004. Cf. also K.J. Hopt, H. Kanda, M.J. Roe, E. Wymeersch, & S. Prigge, *Comparative Corporate Governance: The State of the Art and Emerging Research,* New York, Oxford University Press 1998. See also The Evolution of Legal Business Forms in Europe and the United States, Venture Capital, Joint Venture and Partnership Structures, Tilburg University 2003, for US-EU comparative research.

It focuses on a basic understanding of systems and rules and does not purport to cover the voluminous research on corporate governance in economics, sociology, and most recently, other disciplines such as behavioural sciences and psychology.[34] Before conducting any research in the mentioned areas, a basic understanding of these several systems and rules is necessary.[35] This research will not go into and will not provide an answer to which governance system is more efficient or whether systems will converge.

The research will be limited to securities disclosure and accounting (rules on drawing up, laying before and adoption of the annual accounts/report) obligations for listed public corporations (issuers) and internal corporate/governance rules on the division of powers between board and GMS and (groups of) shareholders. [36] The comparison in chapter 3 will entail an examination of the basic GMS-powers and (groups of) investors with respect to the issuer's governance and corporate structure (division of powers between board and GMS/shareholders), including recent changes. For a more detailed overview of this comparison and analysis I refer to the annexes. In the main text the board supremacy and some core rights of shareholder's meeting and (groups of) shareholders will in particular be analysed. Therefore literature research including doctrine/academic research, statutory corporate and securities law, corporate governance codes (however not in extenso) and case law will be executed.

Issuers are defined as public corporations whose shares are traded on regulated markets, as defined by European law: art. 4 (1) No. 14 of MIFID. The corporate form of the issuer is in theory not restricted to one type of legal form, however under the examined jurisdictions the Netherlands NV, the German AktG, the UK Plc and the US Corporation (Inc.), in general will take the legal form of the issuer.

34 Hopt, p. 1163.

35 Ever since the beginning of European company law harmonization, Member State academia and practitioners have followed this process closely and have sometimes helped to prepare it. In the early stages, the European Commission even commissioned comparative law studies for its work. Although later the practice disappeared, probably due to financial restraints and more orientation to Member State pressure from ministries, politicians and lobbyists, Hopt, p.1174.

36 Second Conflicts of Law § 302, Comment (1971), internal affairs (linked with the seat of incorporation or in some countries the real seat, but also securities rules, i.e. listing rules in board composition) can be described as referring to 'the relations inter se of the corporation, its shareholder, directors, officers or agents … involving primarily a corporation's relationship to its shareholders (and) including steps taken in course of the original incorporation, the election or appointment of directors and officers, the adoption of by-laws, the issuance of corporate shares, pre-emptive rights, the holding of directors' and shareholders' meetings, methods of voting including any requirement for cumulative voting, shareholders'rights to examine corporate records, charter and by-law amendments, mergers, consolidations and reorganisations and the reclassification of shares.' Restatement (Second Conflicts of Law § 302, Comment (1971).

2

Disclosure and accounting[37] Descriptive analysis and comparison of the US and EU regulation (of) issuers and markets, disclosure versus accounting

37 This chapter builds on joint research as reflected in: M.J.G.C. Raaijmakers and P.A.van der Schee, 'Disclosure and Accounting for Issuers in between "Federal" EU Securities Law (and Mandatory Application of IFRS) and National Corporate Law Accounting Concepts', in: P.H.J. Essers, T. Raaijmakers, R. Russo, P. van der Schee, L. van der Tas, & P. van der Zanden (eds.), *The Influence of IAS/IFRS on the CCCTB, Tax Accounting, Disclosure and Corporate Law Accounting Concepts*, Alphen aan den Rijn: Kluwer Law International 2008, p. 87-143.

The Introduction explored the dual regulatory perspective and dichotomy between securities and corporate law to protect investors in financial instruments, particularly shares, by proper disclosure rules and shareholders' rights and powers respectively. This chapter explores and compares in more detail the first layer of investor protection as provided for by US and EU securities law and its relation to corporate law, focussing on the standalone (or mixed) character of initial and continuous disclosure and any impact on the governance of issuers upon going and while being public. This chapter therefore explores from the perspective of the US and EU financial market regulation and securities law the requirements for issuers and the question of whether and to what extent (the regulatory aims of) such regulation affect the internal affairs and governance of issuers upon going and being public. The comparison between the US and (Member States of) the EU will reveal the standalone character of federal US securities regulation and a somewhat mixed character of EU regulation that remains linked to some extent to corporate law. Chapter 3 will take the reverse perspective, looking from the issuer to the market.
'Disclosure' directed at market transparency and investor protection is the cornerstone of US securities law. The new EU securities law essentially chooses the same approach. By a series of directives and regulations, it focuses equally on initial and continuous disclosure rules for issuers. It is equally directed at market transparency and investor protection under public oversight by national authorities. To that extent the 'federal' EU securities law is implemented and 'translated' into the national law of the Member States. It replaced the former self-regulatory rules of stock exchanges and financial markets with strict mandatory securities law. Also, these EU disclosure requirements aim at market transparency and cover insider trading, major holdings, intermediate price sensitive information and periodical reports. Apart from the prospectus requirements in an IPO, the core of the new EU *continuous* disclosure rules is the issuer's annual financial report consisting of its annual accounts, management report (MR) and certification by its responsible persons that these provide a true and fair view. To allow comparability and standardization of disclosure documents, the issuer's *consolidated* accounts shall be drafted in accordance with IFRS. Like the US Report to Shareholders (10K-20F), this annual financial report effectively serves as a standalone market- and investor-oriented disclosure document. For the EU, an important new element is that these disclosure documents are made subject to public oversight, albeit, unlike in the US, by national rather than 'federal' EU agencies.

Furthermore, also unlike in the US, these European securities law rules build on and remain connected with the parallel and still prevailing *corporate* law accounting and disclosure rules of the 1st, 4th and 7th *company* law Directives that apply to *all* (close *and* publicly held) companies. These provide mandatory stakeholder-oriented rules for single and consolidated accounts with their own accounting, mandatory audit and 'disclosure' rules; mandatory deposit of these accounts is required with the commercial register. They apply also to the *single* accounts of issuers. Issuers *shall* apply IFRS in their *consolidated* accounts, but Member States may allow – as many did – these also to be applied in the issuer's single ('legal') accounts. The latter, however, remain connected to the stakeholder-oriented national *corporate* law with emphasis on creditor/shareholder protection rather than market transparency and investor protection. Being left to the MS, public and private enforcement of these combined and entangled new rules reveal remarkable differences.

1 Emerging EU securities regulation: introductory notes

EU securities regulation developed slowly and separately from EU company law, but the growth and integration of European financial markets, the concentration of investments in securities with institutional investors, pension funds and other major players, shareholder activism, the gradual shift towards shareholder orientation of issuers, as well as the strong call for regulation in the aftermath of the series of corporate scandals, accelerated the process in the last decade (see also chapter 3, Introduction).[38] By now, the process of implementation by MS of the new EU securities regulation is completed. The result is a 'federal' standalone set of rules under national public oversight and private enforcement, however still connected with corporate law disclosure rules of the 4th and 7th Directives.

1.1 Financial Services Action Plan and resulting EU securities regulation

The achievement of integrated deep and liquid capital markets to facilitate the free movement of capital has been on the European agenda since the 1960s.[39] The first legislative measure relating to issuers was the Directive on admission to official listing,[40] followed by Directives in 1980s including the Investment Services Directive[41]and the Public Offers of Securities Directive.[42] However, during the 1990s, deficiencies in the existing regulatory regime were considered an impediment to a single capital market, with the passport provision for securities offerings as one of the more obvious failings.[43]

The FSAP, a major effort by the European Commission to equip the Community better to meet the challenges of monetary union and to capitalize on the potential benefits of a single market in financial services,[44] was realized. The FSAP set out a detailed action plan for the

38 H. Merkt, 'Disclosing Disclosure: Europe's Winding Road to Competitive Standards of Publication of Company-Related Information', in: Klaus J. Hopt, Jaap Winter and Eddy Wymeersch (eds.), *Reforming Company and Takeover Law in Europe*, New York: Oxford University Press, 2004, p. 115.

39 Eilís Ferran, *Building an EU Securities Market*, Cambridge: Cambridge University Press 2004, p. 3. This is also the ultimate aim of European Securities Regulation: Dynamic securities markets are vital to Europe's economic future, see 'Quantification of the Macro-Economic Impact of Integration of EU Financial Markets', Financial Report to the European Commission – Directorate-General for the Internal Market by London Economics (in association with PricewaterhouseCoopers and Oxford Economic Forecasting), 12 November 2002.

40 Council Directive 79/279/EEC of 5 March 1979 coordinating the conditions for the admission of securities to official stock exchange listing, OJ 1979 No. L66/21.

41 Council Directive 93/22/EEC of 10 May 1993 on investment services in the securities field, OJ 1993 No. L141/27.

42 Council Directive 89/298/EEC of 17 April 1989 coordinating the requirement for the drawing-up, scrutiny and distribution of the prospectus to be published when transferable securities are offered to the public, OJ 1989 No. L124/8. Eilís Ferran, *Building an EU Securities Market*, Cambridge: Cambridge University Press 2004 p. 4, these Directives made use of the passport concept. The essence of the passport concept is that issuers, investment firms and market structure providers authorized in one Member State can gain access to other Member States without the need for further, local regulatory approvals. The passport concept was conceived as being crucial to the development of a properly integrated pan-European financial market in which issuers, investment firms and investors could operate freely and seamlessly, unimpeded by national boundaries.

43 Eilís Ferran, *Building an EU Securities Market*, Cambridge: Cambridge University Press 2004, p. 4.

44 Financial Services: Implementing the Framework for financial markets – Action Plan, Communication of the Commission, COM (1999) 232, 11.05.99.

adoption of legislative measures to support a single, integrated financial market in which a strong securities market was envisaged as a major component.[45]
The FSAP was the start of a broad renovation of the European securities regulation; the Lamfalussy procedure (new law-making process) (2001) was developed and the creation of the CESR as part of that. The CESR (now ESMA), by coordinating a range of functions, including participating in the law-making process, aims to underpin the development of pan-European consistency in supervisory practices and policies.[46]
Following the FSAP, and accelerated by the post-Enron momentum, the EU soon introduced a completely revised, coherent securities law covering initial and continuous disclosure of issuers upon and after going public under public oversight: Prospectus Directive and regulations (2003), Directive on Admission to Official Stock Exchange Listing (2003), Transparency Directive (2004), Market Abuse Directive(s) (2003) and the IAS Regulations (2002) introducing IFRS as accounting standards for issuer's *consolidated* accounts, amendments for issuers of the 4th and 7th Directive (2006) and the revised 8th Directives on statutory auditors (2006).
The emerging EU *securities law* initial and continuous disclosure regime largely follows that of the US Securities Act and of the Securities and Exchange Act respectively, resulting in a US-like European securities law disclosure system for issuers that can be extracted from these directives.

The *IAS Regulations* (2002)[47] introduced IFRS[48] as the accounting standards to be applied in the consolidated accounts of *issuers* (whose securities are admitted to trading on a regulated market of any Member State)[49] 'with a view to harmonizing the financial information presented by companies in order to ensure a high degree of transparency and comparability of financial statements and hence an efficient functioning of the Community capital market and of the Internal Market'.[50] The use of IFRS should warrant the use of uniform international standards by issuers. The International Accounting Standards Board (IASB) is

45 Eilís Ferran, *Building an EU Securities Market*, Cambridge: Cambridge University Press 2004, p. 1.
46 Eilís Ferran, *Building an EU Securities Market*, Cambridge: Cambridge University Press 2004, p. 7.
47 Regulation (EC) 1606/2002 on the application of international accounting standards, OJ L 243/1 of 11.9.2002 and 1725/2003 adopting certain international accounting standards, OJ L 111/3 of 17.4.2004. For an extensive review of the creation of IFRS by the IASB, the adoption of IFRS by the EC and procedures for revision and extension of IFRS we refer to L. van der Tas & P. van der Zanden, 'The International Financial Reporting Standards', in: P.H.J. Essers, T. Raaijmakers, R. Russo, P. van der Schee, L. van der Tas, & P. van der Zanden (eds.), *The Influence of IAS/IFRS on the CCCTB, Tax Accounting, Disclosure and Corporate Law Accounting Concepts*, Alphen aan den Rijn: Kluwer Law International 2008. For an analysis of the meaning and impact of IFRS for tax accounting we refer to P. Essers& R. Russo, 'The Precious Relationship between IAS/IFRS, national tax accounting systems and the CCCTB', in: P.H.J. Essers, T. Raaijmakers, R. Russo, P. van der Schee, L. van der Tas, & P. van der Zanden (Eds.), *The Influence of IAS/IFRS on the CCCTB, Tax Accounting, Disclosure and Corporate Law Accounting Concepts*, Alphen aan den Rijn: Kluwer Law International 2008.
48 Art. 4 IAS Regulation (EC) 1606/2002, OJ L 243/1.
49 Art. 4 IAS Regulation (EC) 1606/2002, OJ L 243/1.
50 Art. 1 IAS Regulation (EC) 1606/2002, OJ L 243/1.

responsible for the development of IFRS,[51] but to become binding for EU issuers these have to be adopted by the European Commission.[52]

Furthermore, the IAS Regulations allowed EU Member States to permit or require listed and non-listed entities to use approved IAS/IFRS in their statutory/single annual accounts and non-listed companies to use IAS/IFRS in their consolidated accounts. The IAS Regulations also empower the European Commission to endorse such standards to become binding for EU issuers. The standards of the International Accounting Standards Committee (IASC) to be used in the EU should be in line with the principles used in the EU directives on annual accounts and are to be subjected to an endorsement procedure in which the European institutions give the standards its democratic legitimacy, see art. 6(2) of the IAS Regulations. Notably in 2007, IFRS is required or accepted in more than 100 countries. The IASB is discussing convergence projects with major economies like China, India and Japan, designed to ultimately lead to one global accounting standard: IFRS.

In 2007, the unthinkable happened when the SEC decided to accept IFRS for foreign registrants (non-US companies listed in the US) and to start a discussion on the application of IFRS by US companies.[53] It is now no longer a question of whether US companies will at some day be allowed or required to apply IFRS rather than US GAAP, but when.[54] In its disclosed time schedule, the SEC aimed for the possibility for US issuers to apply IFRS in 2014[55], however the SEC recently extended this deadline, the earliest that US companies may be able to use IFRS is now 2015.[56] This implies that the consolidated accounts would only be a disclosure document for the capital markets and would be governed by the rules of the regulators of these markets. It would be necessary to make an opt-out for the obliga-

51 L. van der Tas& P. van der Zanden, 'The International Financial Reporting Standards', in: P.H.J. Essers, T. Raaijmakers, R. Russo, P. van der Schee, L. van der Tas, & P. van der Zanden (Eds.), *The Influence of IAS/IFRS on the CCCTB, Tax Accounting, Disclosure and Corporate Law Accounting Concepts*, Alphen aan den Rijn: Kluwer Law International 2008, p. 1. International Financial Reporting Standards (IFRS) is the official name. However, this set of standards used to be called International Accounting Standards (IAS). There is no difference between the two; the predecessor to the IASB, the International Accounting Standards Committee (IASC) referred to this body of literature as IAS. The name was changed in 2001, when the IASB succeeded the IASC. The 2002 European Union Regulation adopting IFRS for application in the EU, referred to it as IAS as it was too late to change the reference, which makes it slightly confusing.

52 L. van der Tas and P. van der Zanden, 2009, p. 8, A standard can only be endorsed by the European Commission (EC) after consultation of the Accounting Regulatory Committee (ARC), consisting of representatives of the EU Member States. The criteria for such endorsement are whether (i) the standards do not conflict with the principle set out in art. 2 (3) of Directive 78/660/EEC and in Article 16(3) of Directive 83/349/EEC and (ii) are conducive to the European public good and (iii) meet the criteria of understandability, relevance, reliability and comparability required of the financial information needed for making economic decisions and assessing the stewardship of management.'

53 Securities and Exchange Commission, Acceptance From Foreign Private Issuers of Financial Statements Prepared in Accordance With International Financial Reporting Standards Without Reconciliation to U.S. GAAP, RIN 3235–AJ90, Federal Register, Vol. 73, No. 3, Friday, January 4, 2008.

54 For an overview of the history and development of IFRS see the IASB website at <http://www.iasb.org/About+Us/About+the+Foundation/History.htm> and Stephen A. Zef, and Kees Camfferman, *Financial Reporting and Global Capital Markets: A History of the International Accounting Standards Committee*, Oxford: Oxford University Press, 2007.

55 SEC, 17 CFR §§ 210, 229, 230, 240, 244 and 249, [Release, 33-8982; 34-58960; File No. S7-27-08], RIN, 3235-AJ93, 'Roadmap for the potential use of financial statements prepared in accordance with international financial reporting standards by US issuers'.

56 http://www.cfo.com/article.cfm/14478612/c_14479673.

tions of the 7th EU Directive for companies that prepare consolidated accounts for capital market purposes.[57]

The introduction of IFRS fits into the globalization of financial markets and the attempts the internationalization of accounting standards for financial transparency under public oversight.

The regime for annual financial accounts however, also remains, entangled – as a separate layer – with the *corporate* law and 'institutional' disclosure system of the 1st, 4th and 7th Directives and consequently remains intertwined with internal affairs and governance of issuers (corporate law and best practices).

1.2 Simultaneous national use of disclosure as regulatory tool

Other developments caused disclosure to play an increasing role as a regulatory tool towards a standalone market-oriented EU disclosure system for issuers. The execution of the FSAP'99 in the Lamfalussy-procedure coincided with a series of corporate scandals and, hence, a public outcry for regulatory responses. Unlike in the US where SOx enhanced but did not fundamentally change existing securities regulation, these developments in the EU extended and accelerated the emergence of 'self-regulatory' corporate governance codes (e.g. UK, Germany, Belgium, the Netherlands and France).[58] These codes did not build on (or even take into account) the emerging securities regulation of the FSAP'99, but covered a wide range of best practices for issuers resulting in reporting items in issuers' annual reports on, for example, board committees and conflicts of interest, but also on issues directly linked to drafting and preparing the accounts (role of audit committees, audit report, internal controls, in control statements, risk factors, strategy discussion, etc.). *Statutory* 'comply or explain' rules were enacted to require issuers to discuss in their annual report compliance with their national corporate governance code. Thus their scope reveales an overlap of corporate and securities law issues.

The EU High Level Group of Company Law Experts presented their 2002 report (HLG report) [59] and strongly advocated disclosure *as a regulatory tool* over merit (substantive) regulation.[60] It should however be noted that they did not focus on the structure and substance of the new securities law disclosure rules as envisaged in the FSAP'99, but rather on the corporate law rules or internal affairs of issuers and other business forms.[61]

57 As long as an opt-out is not available, listed companies would have to adhere to the 7th EU Directive and have to prepare consolidated accounts based on the EU-Directives as well as consolidated accounts based on IFRS.

58 See *Weil, Gotshal & Manges* 2002; Alain Pietrancosta, 'Enforcement of Corporate Governance Code', as Anton Philips Professor 2008-2009, Tilburg University: Oration: 2008-2009.

59 Report of the High Level Group of Company Law Experts on A Modern Regulatory Framework for Company Law in Europe, European Commission, Brussels, 4 November 2002.

60 High Level Report, p. 33 and H. Merkt, 'Disclosing Disclosure: Europe's Winding Road to Competitive Standards of Publication of Company-Related Information', in: Klaus J. Hopt, Jaap Winter and Eddy Wymeersch (eds.), *Reforming Company and Takeover Law in Europe*, New York: Oxford University Press, 2004, p. 116.

61 HLG report 2002, p. 27, according to the Group's mandate, these key priorities are: the creation and functioning of companies and groups of companies, cooperatives and mutual enterprises, including Corporate Governance; shareholders' rights, including cross-border voting and virtual general mee-

The European Commission responded with its 2003 Action plan to modernize and improve EU corporate law and governance.[62] The EC underlined its intention to preserve the *acquis communautaire*,[63] did not endorse the HLG's claim of superiority of disclosure over substantive regulation and revealed its agenda for action.[64] It refrained from an EU Corporate Governance Code, but did publish recommendations on non-executive directors and on executive remuneration and initiated a directive to enhance shareholders' rights.[65] Remarkably, the European Commission did not elaborate on the standalone character of the new EU securities regulation that was in the process of being finalized and implemented at that point in time.

1.3 Post-Enron (FSA) regulatory responses

The US market and investor-oriented system did not witness such a proliferation of 'self regulatory' corporate governance best practices and disclosure items. US Congress rather limited itself to simply enhancing the prevailing US securities regulation and its disclosure rules. The SOx, subsequent SEC regulation and NYSE and NASDAQ listing rules constituted the regulatory responses[66] to the burst of the dotcom bubble and 'Enronitis'. They do address some corporate governance issues,[67] albeit that their focus clearly remains on market transparency and disclosure.

The Senate Report accompanying SOx stated its purpose: "The purpose of the bill is to address the systemic and structural weakness affecting our capital markets which were revealed by repeated failures of audit effectiveness and corporate financial and broker-dealer responsibility in recent months and years … The bill also requires steps to enhance the direct responsibility of senior corporate management for financial reporting and for the quality of financial disclosures made by public companies."[68]

Public oversight on qualification, quality and ethical standards of registered auditors was introduced (Title I, SOx), auditor independence improved (Title II, SOx), audit and certifica-

tings; corporate restructuring and mobility (for instance, the transfer of the corporate seat); the possible need for new legal forms (for instance, a European Private Company, which would be of particular relevance for SMEs) the possible simplification of corporate rules in light of the SLIM report on the Second Company Law Directive of 13 December 1976 on the formation and capital maintenance of public limited liability companies.

62 Modernising Company Law and Enhancing Corporate Governance in the European Union – A plan to move forward, COM 2003.

63 Modernising Company Law and Enhancing Corporate Governance in the European Union – A plan to move forward, COM 2003, p. 6.

64 H. Merkt, 'Disclosing Disclosure: Europe's Winding Road to Competitive Standards of Publication of Company-Related Information', in: Klaus J. Hopt, Jaap Winter and Eddy Wymeersch (eds.), *Reforming Company and Takeover Law in Europe*, New York: Oxford University Press, 2004, p. 133.

65 Commission recommendation of 15 February 2005 on the role of non-executive or supervisory directors of listed companies and on the committees of the supervisory board, 2005/162/EC and Directive 2007/36/EC on the exercise of certain rights of shareholders in listed companies.

66 J.A. McCahery & J. Armour, *After Enron: Improving Corporate Law and Modernising Securities Regulation in Europe and the US*, Oxford: Hart Publications 2006; John Kenneth Galbraith, *The Great Crash,* 1929; Stuart Banner, *Anglo-American Securities Regulation, Cultural and Political Roots, 1690-1860,* Cambridge: Cambridge University Press 1998.

67 Par. 204, 301, 303 SOx; Par. 303A.06 and 303A.07 NYSE Listed Company Manual.

68 Public Company Accounting Reform and Investor Protection Act of 2002, Senate Comm. On Banking, Hous. & Urban Affairs, S. Rep. No. 107-205, 107th Cong., 2d Sess. 2 (2002).

tion procedures in connection to disclosure documents sharpened (Titles III/IV) and conflicts of interest analysis subjected to more scrutiny (Title V).[69] Auditors' independence from management was amplified as an independent 'public watch-dog',[70] to enhance their role as independent gate-keeping experts.[71] In the EU this role was amplified by the revised 8th Directive.[72] On both sides of the Atlantic, the statutory audit is regarded as a fundamental prerequisite for the proper functioning of the securities and capital markets.[73]
In this context the certification by the CEO and CFO to be inserted into the public disclosure document and the implied warranties on preceding internal controls to be exercised by these officers has to be mentioned. The statement required by art. 4 sub 2 (c) Transparency Directive now requires issuers to make a similar statement.[74]

1.4 Additional reporting items for issuers (corporate governance)

In comparison to the US SOx, which was embedded in the prevailing US securities regulation, the changes in the EU were different. Not building on prevailing and forthcoming EU securities law, the responses of the EU and – simultaneously – of its Member States were fragmented over corporate and securities law rules by different regulatory instruments, primarily by amending prevailing EU *corporate law* directives and issuing new recommendations and – at the national level of Member States – by amending corporate law (see Netherlands strengthening shareholder rights), but also introducing 'self-regulatory' codes of best practice, part of which did focus on the role and organization of boards, the role of executive and non-executive directors, the role of the GMS and, hence, the division of corporate power between these bodies corporate.
Both the 4th and 7th Directives (applicable to *all* 'companies') were amended (2006) to insert new items to be discussed in the MR-related party transactions, but also on collective board responsibility for the financial report and – but this *for issuers only* – the requirement to

69 § 501 SOx-Act. Moreover: § 1107, retaliation against informants, § 1102, tampering, § 1001 Corporate Tax Return, etc.
70 Werner F. Ebke, 'Corporate Governance and Auditor Independence: The Battle of the Private Versus the Public Interest', in: G. Ferrarini, K. J. Hopt, J. Winter and E. Wymeersch (eds.), *Reforming Company and Takeover Law in Europe,* New York: Oxford University Press 2004, p. 182.
71 Art. 22 revised 8th Directive (2006).
72 Introducing e.g. public oversight – comparable to the US PCOAB – on approval and withdrawal of auditors and firms, educational standards and qualifications, registration, professional ethics and secrecy, auditing standards and reporting, quality assurance, investigations and proper sanctions on non-observance of the standards, the introduction of public oversight and international cooperation. Consequently the audit committee plays a crucial role in the process of drafting, accounting and auditing the accounts and the report.
73 Werner F. Ebke, 'Corporate Governance and Auditor Independence: The Battle of the Private Versus the Public Interest', in: G. Ferrarini, K. J. Hopt, J. Winter and E. Wymeersch (eds.), *Reforming Company and Takeover Law in Europe,* New York: Oxford University Press 2004, p. 514.
74 Art. 4 sub 2 (c) TD, the annual report shall comprise: (c) statements made by the persons responsible within the issuer, whose names and functions shall be clearly indicated, to the effect that, to the best of their knowledge, the financial statements prepared in accordance with the applicable set of accounting standards give a true and fair view of the assets, liabilities, financial position and profit or loss of the issuer and the undertakings included in the consolidation taken as a whole and that management report includes a fair review of the development and performance of the business and the position of the issuer and the undertakings included in the consolidation taken as a whole, together with a description of the principal risk and uncertainties that they face.

report on compliance with the issuer's national corporate governance code as well as disclosure of a separate corporate governance statement (remarkably introduced in art.10 of the *Takeover* Directive).[75] The EU recommendations for non-executive directors require several board committees, including an audit committee and set criteria for members' independence.[76] The amended 8th Directive (on auditors) now requires issuers to have an internal audit committee.[77]

Though different from the US, disclosure thus was indeed used as a regulatory tool allowing investors and the market to monitor the compliance with best practices: most of the items mentioned have to be reported upon in the MR. Unlike the *uniform* IFRS for consolidated accounts, the MR does not have to adhere to strict uniform rules. IASB proposals on the MR have not yet resulted in definitive standards. It is one of the elements revealing a potential centripetal force on uniformity that the IAS Regulations evidently aim to achieve in reporting and disclosure by European issuers.

Thus, in the 4th and 7th Directives the report remains distinct from the annual accounts drawn up according to IFRS. The directives provide for minimum items to be discussed but remain open for national additions and interpretations. This differs from the US Report to Shareholders on Form 10-K or 20-F (the content of which follows Regulation S-K) insofar its Management Discussion & Analysis (MD&A) merely forms part of that annual report as a whole. IFRS does not (yet) contain specific provisions on the MR. The statutory content of issuers' reports therefore may differ since different, national requirements (corporate governance codes included) have to be observed in their drafting (RL 4/7 minimum harmonization). Moreover, items related to non-executive directors or supervisory boards in some jurisdictions have to be covered separately, at least in the Netherlands, under Best Practice (III.1.2 DCCG).[78]

1.5 Enforcement

The proof of the pudding remains in the eating. Public enforcement mechanisms and procedures show some remarkable differences in the EU. An illustrative example of entanglement of corporate law procedures on accounting and securities law enforcement of a misleading disclosure document is the statutory suspension of the power of the AFM to request a court order to restate annual accounts *until* the general meeting of shareholders have adopted the accounts.[79]

75 Directive 2006/46/EC of the European Parliament and of the Council of 14 June 2006 amending Council Directives 78/660/EEC on the annual accounts of certain types of companies, 83/349/EEC on consolidated accounts, 86/635/EEC on the annual accounts and consolidated accounts of banks and other financial institutions and 91/674/EEC on the annual accounts and consolidated accounts of insurance undertakings, OJ L 224, 16/08/2006, art. 46a Dir 4 and arts. 50b/50c 4th Dir. and 36a/36b Dir7.

76 Commission recommendation of 15 February 2005, 'On the role of non-executive or supervisory directors of listed companies and on the committees of the supervisory board', 2005/152/EC.

77 Art. 43 8th Dir.

78 Best Practise III.1.2 DCGC, 'The annual statements of the company shall include a report of the supervisory board. In this report the supervisory board describes its activities in the financial year and which includes the specific statements and information required by the provisions of this code.'

79 Arts. 2: 447 and 449 NCC, *after* the GMS has adopted the annual accounts the AFM and interested parties have the authority to file a request with the Netherlands Business Court (Amsterdam) within six

Similarly accounting and disclosure by their nature are closely connected to directors' accountability, liability, discharge and/or indemnification. Accounting is related to the concept of fiduciary duties as 'agent' or 'trustee' to report, account and disclose on the execution of their assignment. The flip side of that coin is that acceptance of the agent's report will discharge him for the period covered by his report, not – evidently – for facts and figures that were concealed by him. This pattern is typical in traditional corporate 'accounting', originating from partnership rules. Upon implementation of the 4th and 7th (stakeholder-oriented) Directives, Member States designed the enforcement thereof partly in the internal governance of companies, sometimes also with specific actions for creditors.[80] These issues and the related best practices as defined in governance codes therefore remain – at least partially – embedded in the traditional corporate law substantive and procedural regulations.

Securities law disclosure, however, focuses on the document(s) disclosed *by the issuer. Public* enforcement therefore focuses on correcting (not IFRS-proof) information that is in the market. *Private* enforcement (if and insofar as this term is extended beyond the use of collective and individual 'member's rights' in the issuer's internal organization) will focus on retention of damages suffered by investors caused by misleading statements (securities fraud). The way in which Member States have created enforcement mechanisms, including causes of action to allow litigation in court, show important differences that may over time affect the evolution of common market principles. In the following, I will compare some of these differences in more detail against the background of the aims of an integrated EU financial market.

2 The regulatory concepts and function of disclosure and 'accounting'[81]

This very brief introductory summary reveals a remarkable difference in the basic and regulatory function of disclosure and accounting in securities and corporate law and high-

months to restate the annual accounts and the annual report. Cf also art. 2:452 NCC which authorizes the AFM to file a request, 6 months after filing of the annual accounts with the AFM, with the BC to order an issuer to give a further explanation concerning the application of IAS. Remarkably, art. 2: 454 NCC and 455 gives the AFM the power to file a request with the BC to order an issuer, which is incorporated in another state, to make an public announcement that their annual financial reports/accounts are not in compliance with requirements under AFS and IAS. This right can be exercised six months after the disclosure of the annual accounts according to art. 5:25c, sub 1 AFS. This procedure is more in accordance with the restatement procedure under US securities law.

80 Art. 2: 138 NCC, which gives creditors the right in bankruptcy situations to file a claim against directors in case of severe breach of their fiduciary duties.

81 Periodically extracting, sorting and summarizing the recorded transactions to produce a set of financial records, also termed financial accounting. The term frequently refers to the report of all items of property, income and expenses prepared by a personal representative, trustee or guardian and given to heirs, beneficiaries or the probate court. As regaerds the business form (and working of the business form in practice) and vision of the corporation (stakeholder/institutional vision v. Shareholder, etc.) the nature of accounting works is different. Art. 2 4th Directive, 'The annual accounts shall comprise the balance sheet, the profit and loss account and the notes on the accounts and Art. 46 sub 1 (a), The annual report shall include at least a fair review of the development and performance of the company's business and of its position, together with a description of the principal risks and uncertainties that it faces.'

lights their different mutual relationship. At first sight, the basic concept of US securities regulation seems to be a standalone market-oriented disclosure concept. That concept also seems to govern the new EU securities law, but – unlike the US – it still seems to be entangled with corporate law accounting. Understanding commonalities and differences requires further analysis of these basic notions.
Black's Law Dictionary defines disclosure as: "The act or process of making known something that was previously unknown; a revelation of facts."[82] In a broader sense, a disclosure regime entails all legally recognized information claims a system of corporate governance or a financial system furnishes financial contracting parties with. This may include private information channels.[83] This description refers to the resulting process or acts rather than to the underlying obligation for disclosure. In contrast, the term 'accounting' is described as: "periodically extracting, sorting, and summarizing the recorded transactions to produce a set of financial records, also termed financial accounting". The term reflects the fiduciary nature of the obligation 'to account' for the acts since it frequently refers to the report of all items of property, income and expenses prepared by a personal representative, trustee or guardian and given to heirs, beneficiaries or the probate court.[84] Let me first turn to the function of disclosure.

2.1 Disclosure

The focus and regulatory function of *securities law* (market) disclosure rules for issuers of securities is to inform the market, notably investors in the market for these securities. These rules are prompted by *going* and *being* public. Mandatory disclosure rules for issuers provide standards for such market information.[85]

82 *Black's Law Dictionary*, Thomson West, St. Paul, 2004.

83 C. Leuz and J. Wustemann, 'The role of accounting in the German financial system', in: J. Krahnen and R. H. Schmidt (eds.), *The German Financial System*, New York: Oxford University Press 2003. Or any legal obligation that requires an issuer's management to provide, on a regular basis, information that it otherwise might not be inclined to provide, Merritt B. Fox, 'Challenges to Corporate Governance: Required Disclosure and Corporate Governance', *62 Law & Contemp. Prob. 113*, 1999, p. 2.

84 Black's Law Dictionary.

85 Investor protection attempts inter alia to mitigate problems of asymmetric and inadequate information. Most jurisdictions rely on mandatory disclosure to protect public investors; Roberta Romano, *Foundations of Corporate Law*, New York: Oxford University Press 1993, p. 301: "insofar as managers are required to disclose information on the use made of the corporate funds and on the business decisions taken by them in the course of their governance, investors are enabled to monitor the agents' behavior. In many cases it is hard to distinguish these different forms of efficiency-enhancing information given by the management to the investors; the capital market function in general (issuer v. investor) and the principal-agent problem in particular (management v. shareholder) for example, when shareholders use corporate information to decide on measures taken against the management (derivative suits etc.) and on the prospect of their investment as such, e.g., in the context of a takeover offer which results from bad management and an ensuing fall of the company's stock price."

2.1.1 Price function disclosure

Its principal objectives are twofold: first, to ensure that the prices of publicly traded securities are reasonably well-informed (accuracy function: prices reflect all relevant information), allowing market participants to determine prices for securities that accurately reflect all available information. Disclosure thus contributes to informational efficiency by enabling traders to gather information, and thereby reflect new information in prices, at a reduced cost compared to a world without disclosure.[86]

2.1.2 Agency function disclosure

Secondly, disclosure contributes to protection of investors by effective corporate governance institutions (monitoring) afterwards (agency function).[87] Both objectives cause regulators to constrain opportunistic behaviour by managers or controlling shareholders (thus addressing the agency problem),[88] by reducing the monitoring costs of promoters' and man-

86 John C. Coffee Jr., 'Market Failure and the Economic Case for a Mandatory Disclosure System', *70 Va L Rev 717* (1984); Frank H. Easterbrook and Daniel R. Fischel, 'Mandatory Disclosure and the Protection of Investors', 70 *Va L Rev* 669 (1984); and Gregg A. Jarrell, 'The Economic Effects of Federal Regulation of the Market for New Security Issues', 24 *J L & Econ* 613 (1981) and Marcel Kahan, 'Securities Laws and the Social Costs of "in accurate" Stock Prices', 41 *Duke L J* 977, 979 (1992); Jeffrey N. Gordon and Lewis A. Kornhauser, 'Efficient Markets, Costly Information, and Securities Research', *60 NYU L Rev* 761, 802 (1985); Ronald J. Gilson and Reinier Kraakman, 'The Mechanisms of Market Efficiency', 70 *Va L Rev* 549, 601 (1984). Eilís Ferran, *Building an EU Securities Market*, Cambridge: Cambridge University Press 2004, p. 130, approaches advocating slimmed-down, agency problem-orientated mandatory disclosure regimes are normative suggestions rather than an accurate description of current regulatory practice around the world. See also, idem, p. 47 and Eugene Fama, 'Efficient Capital Markets: A review of theory and empirical work', 25 *J. Fin.* 383 (1970) and Ronald J. Gilson and Reinier H. Kraakman, 'The Mechanisms of Market Efficiency', 70 *Va L Rev* 549, 601, 1984, p. 3 and the recent article by Gilson and Kraakman, 'The Mechanisms of Market Efficiency Twenty Years Later: The Hindsight Bias', in: John Armour and Joseph A. McCahery (eds), *After Enron, Improving Corporate Law and Modernising Securities Regulation in Europe and the US*, Oxford: Hart Publications 2006, p. 29. And it serves efficiency to gather information and form a judgment on the value of the securities based on such information about the performance of the issuer and all data relevant to the market and thus to be reflected in the stock price to ensure that issuers will provide the market and its participants with proper, adequate, reliable and timely information on their performance and registered securities. Eilis Ferran, *Building an EU Securities Market*, Cambridge: Cambridge University Press 2004, p. 127, behavioural finance scholarship identifies over-optimism and over-confidence as cognitive biases that may contribute towards irrationality in securities markets: see, e.g. L.A. Cunningham, 'Behavioral Finance and Investor Governance', 59 *Washington & Lee Law Review* , 767, 2002 and R. Prentice, 'Whither Securities Regulation? Some Behavioural Observations Regarding Proposals for its Future', 51 *Duke Law Journal* 1397, 2001. Investor irrationality tends to attract particular attention but, as various commentators have noted, regulatory agencies and other rule-makers are also vulnerable to over-confidence and other biases that could distort their decisions: S.M. Bainbridge, 'Mandatory Disclosure: A Behavioural Analysis', 68 *University of Cincinnati Law Review* 1023, 2000 and S.J. Choi and A.C. Pritchard, 'Behavioural Economics and the SEC', 56 *Standford Law Review*, 2003. See also G. Raaijmakers, *The Effectiveness of Rules in Company and Securities Law*, Den Haag: Boom Juridische Uitgevers 2006.

87 See also Frank H. Easterbrook and Daniel R. Fischel, *The economic structure of corporate law*, Cambridge: Harvard University Press, 1991, Roberta Romano, *Foundations of Corporate Law*, New York: Oxford University Press 1993, p. 301 and P. Mahoney, 'Mandatory Disclosure as a Solution to agency Problems' 62 *University of Chicago Law Review* 1047, 1995, p. 2.

88 Reinier R. Kraakman, Paul Davies, Henry Hansmann, Gerard Hertig, Klaus J. Hopt, Hideki Kanda & Edward B. Rock, *The Anatomy of Corporate Law, A Comparative and Functional Approach*, New York: Oxford University Press 2004, p. 194. Nb. there is also a corporate governance function in better pricing accuracy, i.e. market for corporate control and managers are assumed to be incentivised or deterred by the knowledge that performance failures will be likely to affect adversely the value of their share-

agers' use of corporate assets for self-interested purposes and monitoring for the benefit of shareholders, creditors and other interested parties.[89] Regulation of corporate financial disclosure (also in proxy statements) thus aims at enhancing investors' ability to monitor management[90] and their investment decisions. Securities disclosure thus supports and supplements the mechanisms of monitoring, litigation and voting.[91]

Three functions of mandatory disclosure therefore may be distinguished: enforcement, educative and regulatory/legislative.[92] Disclosure rules that target agency problems may not contribute to the accuracy of near-term share prices directly; e.g. rules requiring disclosure of self-dealing transactions between the company and its directors may be critical to controlling manager-shareholder agency problems, even if these transactions are trivial in comparison in comparison to the value of the company's assets or market capitalization.[93]

based remuneration and their chances of further reputationally-enhanced personal career progression, as well as their ability to raise new corporate finance on favourable terms.

89 Reinier R. Kraakman, Paul Davies, Henry Hansmann, Gerard Hertig, Klaus J. Hopt, Hideki Kanda & Edward B. Rock, *The Anatomy of Corporate Law, A Comparative and Functional Approach*, New York: Oxford University Press 2004 and P.Mahoney, 'Mandatory Disclosure as a Solution to agency Problems', 62 *University of Chicago Law Review* 1047, 1995. From a regulatory point of view this perspective of the agency problem would lead to a more backward looking approach: how the firms' money and assets are being used over the reporting period, allowing to spot breaches of management towards shareholders; historical cost accounting then would be appropriate.

90 Alongside other such mechanisms as alignment, bonding, exposure to the market for corporate control and gate keeping. Its effectiveness is however questionable.

91 Roberta Romano, *Foundations of Corporate Law*, New York: Oxford University Press 1993, p. 301.

92 Reinier R. Kraakman, Paul Davies, Henry Hansmann, Gerard Hertig, Klaus J. Hopt, Hideki Kanda & Edward B. Rock, *The Anatomy of Corporate Law, A Comparative and Functional Approach*, New York: Oxford University Press 2004, p. 195 and see Reinier Kraakman, 'Disclosure and Corporate Governance: an overview Essay', in: Klaus J. Hopt, Jaap Winter and Eddy Wymeersch (eds.), *Reforming Company and Takeover Law in Europe*, New York: Oxford University Press, 2004, p. 97.

93 Disclosure of self-dealing transactions are an example of the enforcement function. US securities law requires officers, directors and their immediate family members to disclose a material interest in all related party transactions involving amounts greater than USD 60,000 (SEC Regulation S-K, Item 404 (a)). The second governance function of disclosure is educating public shareholders to make or ratify fundamental corporate decisions. For example, in proxy contests, shareholders require information about the proposed policies and affiliations of competing board candidates. Also a legal requirement that shareholders must approve mergers, or that they must vote on self-dealing contracts between the company and its directors, would be meaningless without disclosure of the proposed terms of these transactions, Reinier Kraakman, 'Disclosure and Corporate Governance: an overview Essay', in: Klaus J. Hopt, Jaap Winter and Eddy Wymeersch (eds.), *Reforming Company and Takeover Law in Europe*, New York: Oxford University Press, 2004, p. 97. Similarly, shareholders who are asked to approve a merger transaction or respond to a tender offer need information that neither management nor the outside bidder will necessarily supply in the absence of a legal requirement to do so, Reinier Kraakman, 'Disclosure and Corporate Governance: an overview Essay', in: Klaus J. Hopt, Jaap Winter and Eddy Wymeersch (eds.), *Reforming Company and Takeover Law in Europe*, New York: Oxford University Press, 2004, p. 98: "From the passage of the securities Exchange Act of 1934 onward, US regulators have justified mandatory disclosure as a means of encouraging the participation of public shareholders in corporate governance. The hope that disclosure might facilitate 'corporate democracy' remains an important current in US securities law to this day, although the historical evidence suggests that SEC disclosure requirements often discouraged shareholder participation in governance in the past."; e.g., J. Pound, 'Proxy Voting and the SEC', 29 *J Financial Economics* 241, 1991.

2.1.3 Regulatory use disclosure

With respect to the legislative/regulatory and the third function of disclosure Professor Kraakman wrote: "Regulators have long appreciated that power over disclosure can be leveraged into power to legislate 'soft' substantive norms of the behaviour for public companies. Corporations are required to report under penalty of law, whether they follow certain norms of good governance and corporate citizenship, or explain why they do not. Depending on the circumstances, these supra-legal norms may be prescribed outright (e.g., disclosure that the directors on the issuer's nominating committee are independent, or explain why they are not), or be left to other authorities, or even the company itself, to determine. But no matter how they are set, these norms will be enforced, so the strategy assumes, largely by the reputational cost to companies and managers of confessing unusually lax standards or governance procedures".[94]

My analysis will reveal that this regulatory function of disclosure in the EU is used more broadly and intensively in the corporate law and governance-oriented MR. Most illustrative is art. 46a 4th Directive requiring issuers to report on the 'comply or explain'-rule on the observance of best practices in the national corporate governance code. These rules remain embedded in the internal affairs of the company. I will show a tension between this additional regulatory aim of disclosure and the stricter and narrower securities law requirements of the EU Transparency Directive and the disclosure of the stakeholder-oriented corporate annual accounts of the 4th Directive.

As will be set out in par. 5.2, the regulatory function of disclosure for the report of EU-issuers shows an 'open-ended' sideway, since the content and comparability of MRs depends on national choices made upon implementation, (the development of) different codes (best practices) of 'self-regulatory' committees/bodies, the way these are supported by listing rules and their 'enforcement'.

2.1.4 Corporate disclosure

The term disclosure can also be used to characterize the mandatory requirements of the 4th and 7th Directives for *all* companies to publish (to be made available to the general public via the commercial register) their accounts by depositing these with the commercial register or company registrar. This concept enlarges the circle of interested parties from shareholders (although those in privately held firms can easily provide for their own accounting rules) to

94 Reinier Kraakman, 'Disclosure and Corporate Governance: an overview Essay', in: Klaus J. Hopt, Jaap Winter and Eddy Wymeersch (eds.), *Reforming Company and Takeover Law in Europe*, New York: Oxford University Press, 2004, p. 98; see his example on the use of this regulatory strategy in the US when the SEC adopted Rule 13e-3 to regulate going-private transactions; Rule 13e-3 requires controlling shareholders who wish to cash-out minority shareholders to disclose whether their proposed transactions are fair to minority shareholders, and, in the course of this discussion, report on a variety of procedural features, such as independent representation for minority shareholders, approval by a majority of the minority vote, approval by unaffiliated directors, that the SEC was clearly holding out as indicia of fairness. See Rule 13e-3 and SEC Schedule M-A, Item 1014 (fairness of Going-Private Transaction).

third parties, primarily creditors. For purposes of tax accounting, tax law itself sets its own accounting and inspection rules.[95]

Evidently, the different meaning and use of disclosure concepts will be reflected in the mechanisms available for their enforcement, e.g. non-disclosure or late/delayed disclosure of 4th Directive accounts exposes the director of a Netherlands company in bankruptcy to personal liability for the deficit (arts. 2:138/248 NCC).

2.2 Accounting

Next, I contrast securities (market-oriented) disclosure with 'internal' accounting[96] of the (management) board to the Annual General Meeting (AGM) (shareholders as members of the organization) and/or the supervisory board and disclosure to the community at large (via deposition of the annual accounts with the commercial register or similar agency). Internal accounting to the AGM is sometimes reflected, such as in the Netherlands, in mandatory rules that require the management and superviory boards to present the *'draft'* accounts to the AGM (as body corporate) to vote on the proposal to adopt these accounts and separately to vote on the proposal to discharge the board.[97] Thus, the adoption of the annual accounts by the AGM remain framed in the traditional accounting rules, i.e. management to account for the financials and its own performance in the past fiscal year vis-à-vis its shareholders (members) *in meeting*.[98]

However, EU company law 4th and 7th Directives reflect a stakeholder-oriented accounting and disclosure system for the public at large as also appears from the Preamble of these Directives.[99] The resulting system thus focuses on *disclosure* of the accounts and reports as well as the auditor's report drafted in accordance with this EU accounting standards to

95 P. Essers & R. Russo, 'The Precious Relationship between IAS/IFRS, national tax accounting systems and the CCCTB', in: P.H.J. Essers, T. Raaijmakers, R. Russo, P. van der Schee, L. van der Tas & P. van der Zanden (eds.), *The Influence of IAS/IFRS on the CCCTB, Tax Accounting, Disclosure and Corporate Law Accounting Concepts*, Alphen aan den Rijn: Kluwer Law International 2008, pp. 29-81.

96 Black Law Dictionary: "periodically extracting, sorting, and summarizing the recorded transactions to produce a set of financial records, also termed financial accounting. The term frequently refers to the report of all items of property, income, and expenses prepared by a personal representative, trustee, or guardian and given to heirs, beneficiaries, or the probate court."

97 The traditional way of accounting by management to participants (shareholders) on the fulfilment of their assignment during the accounting period essentially is a specimen of the more general duty to account in all fiduciary relationships (agents, trustees, partners in partnership).

98 Cf Ella Gepken-Jager, *VOC 1602-2002:400 years of company law*, Deventer: Kluwer Legal Publishers 2005. The Dutch approach originates from the Dutch United East Indian Company (1602) created by charter of parliament granting a trade monopoly for 'the East'. The accounting scheme became the standard form for public companies as enacted in the Napoleontic Commercial Code. Dutch corporate law until 1970 had just one mandatory provision on the annual accounts of public firms and audit which did not prevent the emergence of a broad set of accounting standards. In Germany, the German Aktiengesetz (1874, 1892, revised in 1937 and 1965) framed the corporate law charter of the Aktiengesellschaft as a 'Publikumsgesellschaft' with board supremacy and a supervisory board to which management should account and with own specific accounting rules. The aim was a standalone *corporate* charter for 'public' companies, i.e. companies with dispersed anonymous ownership. Government consent was dropped and replaced by 'materielle Normativbestimmungen' (public oversight on creation being replaced by mandatory substantive rules and norms).

99 Preamble 4th Directive (78/660/EEC), whereas the coordination of national provisions concerning the presentation and content of annual accounts and annual reports, the valuation methods, used therein

serve both the public at large (stakeholders) as well as its shareholders of *all* companies (privately and publicly held).

The different regulatory routes of the US and the EU and its Member States may be illustrated by a brief summary of the principles of and the regulatory policies under the "Roman Treaty" and the role of the judiciary (European Court of Justice). These starting conditions of the EU and US disclosure systems are discussed in following chapters. I focus on disclosure and accounting for issuers.[100]

3 EU corporate accounting and disclosure rules (1st, 4th, 7th and 11th Directives)

In 1958, each of the EU's founding fathers (Belgium, France, Germany, Italy, Luxembourg and the Netherlands[101]) had its own corporate law and (largely) self-regulatory securities regulation drafted by stock exchanges.[102] State oversight (and 'concession') on the creation of ('public') corporations over time had largely been replaced by mandatory substantive rules developing towards an 'institutional' stakeholder-oriented concept of corporations, also on disclosure and accounting. Hence, corporate law was not only directed at protecting shareholders, but also creditors and other 'stakeholders'.

To achieve one common market, the "Roman Treaty"[103] established amongst others the freedom of establishment (arts. 42-49) and of capital (arts. 67-73). (Cross-border) corporate mobility was hardly existent[104] and regulatory competition[105] was restricted by the aims and policies to *harmonize* corporate law (art.44(g)) and adopt regulations for 'federal' European business forms.[106] The power to harmonize corporate law reflects a broad, 'institutional' concept and 'stakeholder'-approach of companies/entities/legal persons (art. 48-2).

and their publication in respect of certain companies with limited liability is of special importance for the protection of members and third parties.

100 Cf. also Friedrich Kubler, 'The Rules of Capital Under Pressure of the Securities Markets', in: Klaus Hopt and Eddy Wymeersch (Eds.), *Capital Markets and Company law*, New York: Oxford University Press, 2003, p. 95, he discusses some of the prevailing theories explaining the rules on capital as an element of a specific "culture" or as the product of 'path dependence'. This suggests a different approach by arguing that the emergence as well as the elimination of rules on capital can be traced to changes in financial markets.

101 Extended in 1973 extended with the UK, Ireland and Denmark, and with Greece (1981) Portugal and Spain (1986), Austria, Finland and Sweden (1995), Cyprus, Estonia, Hungary, Latvia, Lithuania. Malta, Poland, Slovenia, Czech Republic (2004), Bulgaria and Romania.

102 Belgium has since 1935 provided for an act on securities regulation that resembles the US SA'33 and SEA'34

103 1 January 1958, amended by inter alia, Treaties of Maastricht (1993), Amsterdam (1997) and Nice (2001).

104 *Daily Mail.* See Case 81/87 *The Queen v Treasury and Commissioners of Inland Revenue, ex parte Daily Mail and General Trust* [1988] ECR 5483; cf. Joseph A McCahery and Erik P.M. Vermeulen, 'Understanding Corporate Mobility in the EU', Working paper for the 5th European Company Law and Corporate Governance Conference in Berlin, June 2007

105 France feared the Netherlands would become the 'European Delaware'. Harmonization should prevent this.

106 See e.g. the EEIG, SE, SCE, and the recent plans for an EPC.

Art.44(g) focuses on protecting the interests not only of members (and investors) but also of third parties. Though restricted by the subsidiarity principle[107] and unlike in the US, the EC's initial aim (arts. 44 (2) (g) and 48 (2) "Roman Treaty") was undoubtedly to harmonize all major company law issues as perceived over time focussing on 'public' companies but over time on *all* types of limited liability companies. The EU's corporate law harmonization program, including accounting and disclosure rules, was strongly influenced by the then recent German AktG (1965) as a standalone statute for *formal* 'public' management managed corporations. This was reflected in the 1970 draft SE Statute: *the corporate charter* itself should protect the interests of shareholders, creditors, employees and others, also – in Title VI – by extensive provisions on drafting, adoption and audit of (single and consolidated) annual accounts.[108] This draft SE Statute *de facto* seem to have served as the EU agenda for harmonization of corporate law (not securities law). Remarkably, but consistent with art.44(g), no *substantial* distinction was made between public (listed/traded) and privately held corporations, both types reflected a stakeholder orientation, also on corporate accounting, disclosure and audit.

3.1 EU corporate accounting rules

The 1st Directive is the core of the EU-style corporate disclosure system. To enhance trade within the Common Market – it facilitates access to basic data of 'companies' as market participants and their branches (11th Directive[109]) by requiring disclosure (through filing with the commercial register or similar agency) of their corporate data: instrument of constitution (incorporation) and amendments, (powers of) managers, subscribed and authorized capital *and* (!) the annual accounts as required by the 4th and 7th Directives (audited single and consolidated accounts). The initial exemption of *private* companies was dropped later.[110] In the US no such general rule prevails.[111]

107 According to art. 5 of the Roman Treaty, the EU shall not take any measures which are not covered by explicit or implicit powers conferred upon them under the EC Treaty. Cf art. 44 (2) (g) (formerly art. 54 (3) (g) EEC) provides that the Council, the Commission and the European Parliament shall 'coordinate to the necessary extent the safeguards which, for the protection of the interests of members and others, are required by Member States of companies or firms within the meaning of the second paragraph of Article 48 with a view to making such safeguards equivalent throughout the Community'.

108 Remarkably, annual accounts were to be adopted by management and supervisory board and only in case of disagreement between these bodies by the GMS (arts. 211-219).

109 11th Directive, 89/666/EEC, concerning disclosure requirements in respect of branches opened in a Member State by certain types of company governed, by the law of another State, OJ L 395/36, 30 December 1989.

110 Vanessa Edwards, *EC Company Law*, New York: Oxford University Press 1999 , p. 122, the final version of the Directive applied to public and private limited-liability companies as covered by the 1st Directive. Limited liability became the criterion because such companies' activities frequently extend cross-border and offer no safeguards to third parties beyond their net assets (2nd recital preamble).

111 Nonpublic firms in the US have no legal obligation to draft annual accounts, to have these audited, to submit these with an auditor's opinion to their shareholders or partners for adoption or approval and subsequently to disclose these to the public through filing with a public commercial register. Disclosure is not a 'condition' for the grant of limited liability. The corporate charter *may* provide for inspection rights and accounting to shareholders like in partnerships or other non-corporate firms. See Reinier R. Kraakman, Paul Davies, Henry Hansmann, Gerard Hertig, Klaus J. Hopt, Hideki Kanda & Edward B. Rock, *The Anatomy of Corporate Law, A Comparative and Functional Approach*, New York: Oxford University Press 2004, p. 8 and 79; Judith Freedman, 'Limited Liability: Large Company Theory and Small Firms!' *Modern Law Review*, Vol. 63, No.3, May 2000

Hence *all* 'public' (including issuers and close[112]) 'companies' shall disclose their annual accounts (art. 2, 1st Dir.) and account to their shareholders by means of single *and* consolidated accounts (art. 2, 4th Dir and art.1, 7th Dir.). (Partial) exemptions and mitigations are available for (very) small firms.[113] The directives also apply to issuers.
The 4th and 7th Directives distinguish the annual accounts (balance sheet, P&L and notes thereto: art. 2, 4th Dir.) from the annual report (art.46). The accounts shall be drawn up in accordance with the accounting standards provided by the Directive (art. 2, 4th Dir. and art. 16, 7th Dir.). Detailed explanatory *notes to the accounts* shall be provided in accordance with art. 4 (3) (as amended in 2006): valuation methods, list of subsidiaries, shares and share capital, off-balance commitments, number of employees, tax liabilities, compensation schemes, etc. These notes shall also explain risks of off-balance transactions and related party transactions.[114]

Management shall also draft an *annual report* (art. 46, 4th Dir. and 36, 7th Dir.), including at least a fair view of the development of the company's business and of its position, principal risks and uncertainties it faces, a balanced and comprehensive analysis of the development and performance of the business: financial and non-financial key performance indicators, environment and employee matters, post balance sheet events, future development, research and development, branches, details on financial instruments being used. Art. 46a (inserted in 2006; cf. art. 10 Takeover Directive) requires *issuers only* to include a corporate governance statement in their report. The regulatory use of the annual financial report will be further elaborated in par. 5 below, which shows how reporting requirements for issuers based on EU securities law remain intertwined with those of the corporate law directives and, hence, national corporate law.

3.2 EU corporate disclosure

All these corporations shall 'publish' their *duly approved* annual accounts and the annual (management) report together with the auditors' opinion as laid down in national law according to the 1st Directive (arts. 47-50a 4th Dir. and 38 Dir7). This duty to 'publish' is discharged by filing these documents with the commercial register (or similar agency such as a companies registrar): 'duly approved' means that according to *corporate* law the document must be 'final' and definitive, i.e. adopted by the competent body corporate within the internal organization of the issuer.[115] The disclosure rules of the EU 4th and 7th *company law* Directives are *corporate* not *securities* law. As will be set out below-securities law disclosure requires

112 German GmbH, French SàRL, Netherlands BV, Italian SaRL, UK private companies limited by shares or by guarantee.

113 Member States may permit SMEs to draft abridged balance sheets and notes (art. 11 and 44). Art. 47 (2) extends the scope: Member States may relieve them from publishing audited accounts.

114 §§ 401, 402 and 403 SOx. RL 9; Action Plan; annual statements.

115 Art. 47 (1) 4th Dir. and art. 38 (1) 7th Dir., the annual accounts, duly approved, and the annual report, together with the opinion submitted by the person responsible for auditing the accounts, shall be published as laid down by the laws of each Member State in accordance with art. 3 of Directive 68/151/EEC. See also art. 2: 394 sub 1 NCC, the corporation is required to make public the annual accounts 8 days after it has been adopted. Art. 2:394 sub 2 provides for a sanction when the annual accounts are not yet adopted by GMS in the prescribed term (13 months as a maximum) that the board will make public the annul accounts according to the procedure described in art. 2:394 sub 1 NCC, see J.J.M.

prompt disclosure of the annual financial report upon being finalized even if corporate law assigns adoption of the accounts to the annual meeting of shareholders. Upon adoption by the AGM – as in the Netherlands provided by corporate law – the document shall again be 'published' by filing with the commercial register, i.e. many weeks after its earlier *securities* law disclosure according to the AFS.[116]

The German AktG illustrates the notion of why corporate law transparency was linked to the statutory (formal) business form of the AG rather than to this being listed/traded: publication of the accounts and its link to capital protection rules intended to serve not only to protect shareholders, but also to enable creditors and other third parties to assess the financial position of their (potential) debtor.[117]

3.3 EU institutional corporate disclosure design

The resulting EU *corporate* law system (applicable to both private and 'public' type companies and *irrespective* whether these are 'issuers') thus focusses on *disclosure* of the accounts (including the reports) drafted in accordance with the common EU standards and audited by an independent auditor accordingly serve the public at large rather than accounting to shareholders only.[118] Disclosure in this context means: depositing the accounts with the commercial register (or similar agency). Still, the accounts remain framed in the traditional basic pattern that management 'accounts' for discharging their duties vis-à-vis the corporation by presenting its report (financials and narrative report) to its shareholders (and/or its supervisors).

Maeijer, *Asser 2-III Vertegenwoordiging en Rechtspersoon, De Naamloze en de Besloten Vennootschap*, Deventer: Tjeenk Willink 2000

116 Art. 5:25c AFS and art. 5:25i sub 2 and art. 5:53 sub 1 AFS.

117 These provisions constrain a flexible pay-out policy (dividends, distributions) since they can imply a formal change of the articles of incorporation to decrease the company's capital. The amended 2nd Directive now allows more flexibility: Directive 2006/68/EC of 6 September 2006 amending Council Directive 77/91/EEC. Specific reporting and disclosure rules are applicable in case of changes of capital and other incidental corporate reorganizations: (cross-border) legal mergers and splits (3rd, 6th and 10th Directive): 3rd Directive, concerning mergers of public limited liability companies, OJ L 295/36, 6th Directive concerning the division of public limited liability companies, L 378/47.and 10th Directive 2005/56/EC on cross-border mergers of limited liability companies.

118 Marco Becht, 'European Disclosure for the New Millennium', in: Klaus Hopt & Eddy Wymeersch, *Capital Markets and Company Law*, New York: Oxford University Press 2003, p. 87-91, strongly pleads for a shift towards electronic filing; cf. *Jaap Winter*, report 2002, par. 3.1., European Commission, Action Plan (may 2003), par. 3.1.2. Until now, the EU has no such electronic register like the US 'EDGAR' electronic filing system. See however consultation and report of EC on reviewing the execution of the Transparency Directive in the several MS; the review of the operation of Directive 2004/109/EC: emerging issues Accompanying document to the Report from the Commission to the Council, the European Parliament, the European Economic and Social Committee and the Committee of the Regions Operation of Directive 2004/109/EC on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market COM(2010)243, p. 17, so far no positive results are reached with the storage of regulated information in the MS; access to historical information on listed companies on a pan-European scale has not been simplified: interested parties need to go through 27 different national databases. Compared with the US, where a single electronic database exists <http://www.sec.gov/edgar.shtml>, the EU situation is not positive. Therefore the EC will launch a feasibility study on the development of a pan-European storage system for regulated information.

This whole 'internal' process remains applicable for issuers as well, at least in principle. It finally results in *the* disclosed annual financial part and its constituent parts (single, consolidated accounts, MR and the board-statement on the fairness of these documents, external auditor's opinion) to follow and remain embedded in the internal governance of the issuer as set out by mandatory corporate law and its articles of association. For *issuers* these duties are extended by 'applicable' best practices as set out by national corporate governance codes that – in turn – remain entangled with and extend both 'governance' and 'disclosure' rules without clearly distinguishing between them. The nature of these disclosure and 'accounting' rules, certainly if viewed separately, may look to be 'technical', but in the governance charter of the reporting entity (also issuers) they reflect the basic principles and regulatory choices that over time have been made by the EU and national regulators for, inter alia, the division of powers between management and shareholders, the role, powers and core (entrepreneurial) assignment of directors vis-à-vis NED (SB), common and distinct accountability, responsibility and ultimate liability of directors and non-executive directors (one or two tier), gate keeping by external auditors and – finally – public oversight by governmental agencies. In corporate law and practice such rules are reflected in technical and procedural rules on the series of steps to be taken before the final dissemination of the annual financial report: internal control and preparations, final drafting, submission to and discussion with audit committee and auditor, subsequent submission to and 'approval' by full board and supervisory board or non-executive directors, establishment of final and formal 'approval' and signing to also assume responsibility for the completeness and fairness of the financials and the overall view given in the MR, submitting (laying down) the document for the shareholders and/or the AGM, simultaneous disclosure to market and the public at large, discussion of the document in the AGM and in some jurisdictions even 'adoption' of the accounts (as part of the report), updating auditors opinions and subsequent 'final' corporate law disclosure of the document by filing with the commercial register (or similar agency). From the market-oriented perspective of securities law it may be clear that prompt disclosure of the annual accounts has to follow their completion *by the Board* and the submission of the final opinion of the external auditor: this is price-sensitive insider information par excellence. The notion is to prevent information asymmetry and abuse of inside information.

All these steps and elements are part of the corporate law design of the corporation and differ from Member State to Member State. The draft 5th Directive envisaged harmonizing the basic corporate law rules thereof, including the final adoption of the accounts by the AGM[119]

119 The draft 5th Directive intended to harmonize such rules by ordering that the accounts together with the management report and audit opinion should be submitted to the AGM for adoption/approval, which resolution directly and indirectly would discharge the board for its reported performance. This draft directive dealt with the very core of corporate governance of 'large' formal public companies (*not issuers*): board structure, codetermination, division of powers between management, non executive directors and GMS and other governance issues. The subsequent debate essentially was on the choice between shareholder and employee orientation, in the sense used by Reinier R. Kraakman, Paul Davies, Henry Hansmann, Gerard Hertig, Klaus J. Hopt, Hideki Kanda & Edward B. Rock, *The Anatomy of Corporate Law, A Comparative and Functional Approach*, New York: Oxford University Press 2004. Inspired by the German Aktiengesetz (1965) the 1972 draft essentially aimed at harmonizing the basics

and appointment of and assignment to the external auditor. Not surprisingly no agreement could be reached since the core of the dispute related to the regulatory choice between a (more institutional) shareholder- or employee-oriented corporate governance system. The draft was finally withdrawn by the European Commission in 2004.
I conclude that the 4th and 7th Directives (accounting standards, audit and disclosure) are directed at all companies.[120] They apply to the (single) accounts of issuers that have to adhere thereto and follow the internal and external rules, also on formal approval, which will cause tensions with *securities* law rules (prompt disclosure upon 'completion') in jurisdictions where the annual accounts are adopted by the AGM or the SB (to accept and approve the board's 'accounting'). Before I can further discuss these tensions in that area I now turn to the basic characteristics of securities law rules on disclosure for issuers.

4 Investor protection and market regulation in the perspective of securities law: the US and EU model

Therefore we now turn to the perspective of financial markets and securities regulation that emerged over the last decade and accompanied a shift of public attention and regulatory actions to integrate the EU financial markets, to enhance market integrity and protect investors in securities by mandatory rules. It resulted in a market-oriented disclosure system under public oversight, replacing largely self-regulation and oversight by stock exchanges. A brief comparative analysis of the US and EU securities disclosure system illustrates that the US system is completely market-oriented and that periodic (continuous) disclosure is integrated with transactional disclosure. The US annual financial report functions as a standalone securities law disclosure document. It will be shown that the EU securities disclosure system largely resembles the US system, although the disclosure of the EU annual financial report (art. 4 Transparency Directive) appears to remain connected to EU corporate law concepts.

of corporate governance by mandatory 'internal' governance rules: the division of powers between management, supervisors (non executive directors) and the GMS. COM (72) 887 final, 18 July 1972, JO C 131/49; EC Bull Supp 10/72. First draft 1972. Last official draft: COM (91) 372 final, 20 November 1991; (1991) OJ C321/9. In 1996, the Commission asked Ernst & Young to consider the relevance of the draft 5th Directive in the study it had commissioned on corporate governance. The Commission decided to draw back the proposal on 9 January 2004, OJ C 5/20 (2004), Vanessa Edwards, *EC Company Law*, New York: Oxford University Press 1999, p. 389. Two highly controversial proposals were the mandatory creation of a two-tier board structure (art. 2 5th Directive) consisting of a managing organ and a supervisory organ and mandatory provisions for employees' representation on the supervisory board for companies with a workforce greater than 500, art. 4(2) (3). See Vanessa Edwards, *EC Company Law*, New York: Oxford University Press 1999, p. 388.

120 See also Wolfgang Schön, 'Corporate disclosure in a Competitive Environment, – The ECJ's Axel Springer Case and the quest for a European Framework for Mandatory Disclosure', *Working Paper No 55 ECGI*, 2006 and Axel Springer Case C-435/02 and C-103/03 (*Axel Springer G v. Zeitungsverlag Niederrhein GmbH & Co Kg* and *Axel Springer AG v. Hans Jürgen Wuste*), where the ECJ acknowledges the broad disclosure philosophy of the 1st, 4 and 7th EU corporate law Directives.

4.1 The US securities law disclosure system

The regulatory response of US Congress to the crash of 1929 as embedded in the New Deal policies of President Roosevelt and influenced by the UK Gladstonian revisions of the late 19th century clearly focussed and built on the concept of market transparency and full initial and continuous disclosure of issuers in the primary and secondary market. This resulted in an integrated[121] disclosure system that remains[122] the core of the federal US securities regulation (and listing requirements[123]) since its inception in the SA'33[124] and the SEA'34[125]. Disclosure philosophy has been described as the most characteristic of US securities law.[126] Overtime, the SEC's regulatory policies on accuracy enhancement shifted focus from *accountability* of management to their shareholders towards disclosure *by the firm.* Disclosure requirements shifted from backward-looking 'accounting' to forward-looking disclosure on the business: forward-looking statements, current market valuation and segment reporting.[127]

4.1.1 Transactional disclosure

Securities law disclosure is prompted by *going public* (IPO) and hence limited to *'issuers' irrespective* of the (domestic or foreign) legal form of their business organization. An IPO requires a registration statement to be filed with the SEC, the substance of which is a circular ('prospectus') for the securities that the issuer (and/or underwriters) is offering to the

121 Historically (previously) required disclosures under the two Acts had been developed independently of each other, Louis Loss and Joel Seligman, *Fundamentals of Securities Regulation*, New York: Aspen Publishers 2004, p. 151. Through a series of changes in 1982, the SA'33 and SEA'34 disclosure systems have been largely integrated and made consistent and non-redundant; see Milton H. Cohen, 'The integrated Disclosure System – Unfinished Business', 40 *Bus. Law.* 987, 1984-1985, p. 1. *Milton H. Cohen* pleaded in its influential law article, 'Truth in Securities Revisited', (Milton H. Cohen, 'Truth in Securities Revisited', 79 *Harvard Law. Review*, 1965-1966. Vol 79: 1340) that a new coordinated disclosure system should be created having as its basis the continuous disclosure system of the 1934 Act and treating '1933 Act' disclosure needs on this foundation. A coordinated disclosure shifted from the SA'33 sporadic, ad hoc disclosure to the 1934 Act's continuous disclosure system. Continuous disclosure under SEA'34 was improved to enable self-registration allowing issuers having all relevant information on public file to issue new securities with a quick short form registration for new securities. Cf EU Prospectus Directive art. 9.

122 Although some scholars question the mandatory character of disclosure, e.g. Roberta Romano, 'Empowering Investors: a Market Approach to Securities Regulation', 107 *Yale L.J.* 2359, 1998; see the reaction of Merritt B. Fox, 'Retaining Mandatory Securities Disclosure: Why issuer choice is not Investor Empowerment', *University of Michigan Law School Working Paper 99-008*, 1999.

123 See § 201.00 NYSE Listed Company Manual and i.e. Rules <http://www.complinet.com/nasdaq/display/display.html?rbid=1705&element_id=1010 \t "_blank" 4310 (c) (16)> and <http://www.complinet.com/nasdaq/display/display.html?rbid=1705&element_id=1011" \t "_blank" 4320(e) (14)> of the NASDAQ Rules.

124 Primary focus: initial distribution of securities upon being registered with the SEC by the issuer.

125 Addressed to post-distribution trading: continuous disclosure, periodic reports by issuers and insiders (directors, officers, and 10 percent holders) and solicitation of proxies. Eilís Ferran, *Building an EU Securities Market*, Cambridge: Cambridge University Press 2004, p. 127.

126 Eilís Ferran, *Building an EU Securities Market*, Cambridge: Cambridge University Press 2004, p. 127 and J. R. Macey, 'A Pox on Both Your Houses: Enron, Sarbanes-Oxley and the Debate Concerning the Relative Efficacy of Mandatory Versus Enabling Rules'81', *Washington University Law Quarterly* 328, 330, 2003 and S.M.Bianbridge, 'Mandatory Disclosure: A Behavioural Analysis', 68 *University of Cincinnati Law Review* 1023, 2000.

127 Thus facilitating self-registration; cf P. Mahoney, 'Mandatory Disclosure as a Solution to agency Problems', 62 *University of Chicago Law Review* 1047, 1995.

market. This should enable the public to take a well-informed and considered investment decision. By its very nature of a selling document, it is not an 'accounting' document but rather a description of the securities that are offered for sale and, of course, of the issuer (e.g. its past performance, outlook and governance). It provides a detailed description of the securities offered for sale to the public in accordance with the mandatory initial disclosure of a registration statement[128] by the promoter in an IPO as regulated in the SA'33 and Regulation S-K, i.e. detailed historical (past performance) and actual financial and non-financial data of the issuer, internal organization, rights and powers of investors attached to the securities and historical financial data. The SA'33 strongly focuses on preventing fraudulent behaviour by promoters.[129] See e.g. § 11[130] and § 12 SA'33[131] on registration and prospectus liability.

4.1.2 Periodic (continuous) disclosure

The requirements of the SEA'34 for continuous disclosure essentially extend such initial to continuous disclosure in order to keep investors and the market periodically and currently updated to allow investment decisions to be based on current prices that reflect and absorb such actual information. It also allows investors to monitor the performance of the firm and its incumbent management and, if they feel necessary, to use their shareholder rights and proxy mechanism with respect to election and dismissal of management.

Using its regulatory powers[132] the SEC focuses by means of rules, regulations and releases on enhancing the accuracy of initial and continuous disclosure by issuers.[133] Issuers are held to continuous disclosure requirements as long as the issuers' securities are *traded*, also if they are not registered or listed.[134] These issuers become subject to the periodic

128 All securities tradable in the US shall be *registered* with the SEC with a registration statement to be filed with and approved by the SEC (§ 5 SA'33 and Rule 400 ff). par. 6 and 8 SA method and procedure of registration, §§ 7 and 10 SA and Schedule A, contents registration document and prospectus and Form S-1 is the form to be used by commercial and industrial companies. Forms S-2 and S-3 for corporations under the integrated disclosure system. Forward-looking information, § 27 A (a), applicability, forward-looking statements made by inter alia, the issuer that is subject to reporting requirements SEA'34, § 27 (A) (b), exclusions, § 27 (A) (c), safe harbour itself, par. 27(A) (i), definitions forward looking statement. Regulation S-K, Item 10 (b), Commission encourages the use of management's projections of future economic performance, that have reasonable basis and presented in appropriate format. See 175 Acts Rules for definition forward-looking statement (3b-6, SEA Rules). Cf the prospectus requirement in EU law. See par. 5.1. below.

129 Cf UK (P. Mahoney, 'Mandatory Disclosure as a Solution to agency Problems', 62 *University of Chicago Law Review* 1047, 1995).

130 § 11 civil liability on the issuer, directors, certain officers, the underwriters, accountants, engineers and other experts, when the registered statement contains material misstatements or omits to state material facts.

131 § 12, Civil liabilities in connection with prospectuses and communications, § 12 (a) (1), any person who offers or sells a security in violation of section 5, § 12 (a) (2), imposes civil liability upon any person who offers or sells any security by means of material misstatements or omissions to state material facts.

132 § 19 SA'33. The regulatory power of the SEC is limited to federal securities law and does not extend to corporate state law that, under the interpretation of the US Constitution remains the realm of individual states.

133 By means of regulation for the offering circular, annual accounts, interim reports, insider trading, proxy solicitation and prevention of abusive practices of the issuer and market participants.

134 Issuers that a) have a class of securities listed on a national securities exchange, § 12 (b) SEA'34, b) have assets in excess of $ 10 million and c) have a class of equity securities held by a least 500 persons.

reporting requirements of § 13 (a). Regulation 13A outlines the required filings by the Commission under § 13 (a). These filings are on Form 10-K for annual reports (20-F for foreign issuers),[135] 10-Q for quarterly reports[136] and 8-K for reports on incidental materially important events.[137]

The continuous disclosure under SEA'34 is underscored by the proxy rules under § 14 (a), the solicitation of proxies with respect to registered securities must comply with the Commission's rules,[138] tender offer rules, the Williams Act provisions §§ 13 (d)[139], (e) and 14 (d)-(f) regulate tender offers and require certain beneficial ownership reports and § 16 SEA'34 which imposes certain controls over insider trading practices.[140]

The SOx influenced the reporting requirements under the SEA'34 in a number of ways,[141] including quick disclosure on materially adverse changes in the issuer's financial condition.[142]

4.1.3 Financial reporting, internal control and audit

The duty to file with the SEC (and thus: *disclose*) periodical and other reports (yearly, quarterly, material intermediate information[143]) are addressed *to issuers,* i.e. public corporations (*not* to its board or officers). The disclosure system does not serve nor is it aimed at 'internal' corporate law accounting to the AGM (shareholders as members of the organization) or the SB and disclosure to the community at large, but at market transparency and investor protection.

§ 12 (g) (4), registration of any class of security is terminated 90 days after the registrant files a certification that the number of holders of record of that class of security is reduced below 300.

135 Annual report to be filed within 60 days after year end: Rule 13a-1; Form 10-K, Gen. Instruction A.

136 Rule 13a-13, Form 10-Q every issuer has to file a quarterly report.

137 Rule 13a-11, Form 8-K, current report on Form 8-K within 5 or 15 days after occurrence-specified events. NYSE Listed Company Manual par. 202.05, listed firms shall release promptly any news or information that might reasonably be expected to materially affect the market for its securities.

138 Rule 14a-3(a), no solicitation subject to the Rules unless each person is concurrently furnished with a publicly filed proxy statement containing info specified in Schedule 14A, or with a proxy statement included in a registration statement filed under the SA '33.

139 § 13 (d) (1), any person 'directly or indirectly' acquiring more than 5% of stock in a publicly held corporation must file statement on SEC Schedule 13D disclosing that acquisition. Schedule 13D, 1) exact number of shares purchased by group or person doing the filing, 2) source and amount of funds used to make the purchase, including details about who lent the money to the buyer, if part of the purchase price was borrowed, 3) purchaser's purpose in buying shares, including any plans he may have to seek control, to cause a merger to take place, to sell a large part of the company's assets, etc., 4) any plans the filer has to take the company private. Item 4, requiring disclosure of the purpose of the transaction.

140 § 16 (a) (1), 'Every person who is directly or indirectly the beneficial owner of more than 10 percent of any class of any equity security which is registered pursuant to section 12, or who is a director or an officer of the issuer of such security shall file the statements required by this subsection with the Commission.'

141 Inter alia, certification CEO and CFO (§ 302, cf SEA rules 13a-14 and 15d-14); ban on director loans; §§ 404, 406 and 407 on managements assessment of internal controls, codes of ethics for financial officers, and disclosure of financial experts on audit committees.

142 Each reporting company shall disclose to the public on a rapid and current basis such additional information concerning material changes in the financial conditions or operation of the issuer. The Commission's response to its mandate under § 13(l) has been to increase the items required to be reported on form 8-K and to shorten the time within which that form must be filed.

143 The latter should follow form 8-K for domestic and 6-K for foreign issuers.

As a matter of securities law they shall 'make and keep books, records, and accounts, which, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the issuer'.[144] The SEA'34 further requires the issuer to devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that transactions are recorded as necessary to permit the preparation of high quality accurate financial statements in the disclosure document(s).[145]

The SOx of 2002 mainly focussed on enhancing the accuracy of disclosure in the annual report to shareholders. SOx requires the CEO and CFO personally to certify the accuracy of the disclosure of periodic reports (§§ 404 and 906 SOx). It also requires issuer to have an audit committee, assigned to appoint, compensate and oversee (the work of) the issuer's external auditor who also reports to the audit committee.[146] For my comparative analysis it is interesting to note that some of these provisions have been criticized by US scholars and practitioners to create an intrusion of state corporate law[147] [148]. The NYSE and NASDAQ's listing rules (approved by the SEC) provide for some corporate governance issues (audit committees, board composition), but these remain primarily focussed on improving the quality of disclosure. Unlike the EU, the US did not witness a proliferation of 'self-regulatory' corporate governance codes or recommendations at the borderline between securities law and the issuers' internal affairs. As will be demonstrated in chapter 4, this different approach to corporate governance can have a profound influence on the supremacy and discretion of the board in a listed public corporation.

4.1.4 Annual report (Form 10-K and 20-F)

The core rules of continuous disclosure focus on the annual accounts. Issuers have to file with the SEC (i.e. 'disclose') their audited annual report normally within 60 days after year end.[149] These reports shall follow the rules as set for the use of Form 10K (20-F for foreign issuers[150]) and Regulation S-K. The financial statements (balance sheet, profit & loss account) shall follow Regulation S-X,[151] which adheres to the US GAAP of the Federal Accounting Standards Board (FASB) and reflect all material correcting adjustments that have been identified by a registered public accounting firm in accordance with US GAAP and

144 § 13b (2)(A) SEA'34.

145 § 13(b)(2)(B).

146 Via listing rules to be approved by the SEC § 19 (b) (1) SEA'34; § 301 SOx.

147 See, e.g., Roberta Romano, 'The Sarbanes-Oxley Act and the making of Quack Corporate Governance', *NYU, Law and Econ Research Paper 04-032*, 25 September 2004 and Roberta S. Karmel, 'Realizing the Dream of William O. Douglas – The Securities and Exchange Commission Takes Charge of Corporate Governance.', *Brooklyn Law School, Public Law Research Paper No. 7*, 2005.

148 W.B. Chandler and L.E. Strine Jr., 'The New Federalism of the American Corporate Governance System: Preliminary Reflections of Two Residents of One Small State', 152 *University of Pennsylvania Law Review* 953, 2003.

149 § 13(a)(2) '34 Act and secs. A and D Form 10-K.

150 Foreign issuers are exempted in several ways and allowed to follow home country practice. See Rule 12g-3-2 exempting foreign issuers if they or their home country government annually furnishes the Commission with information required by home country rules distributed to its shareholders.

151 Item, 3-02 (a), Regulation S-X, filing for the registrant and its subsidiaries of audited consolidated balance sheets at the end of each of the two most recent fiscal years, as well as audited statements of income and cash flows for each of the three fiscal years preceding the date of the most recent audited balance sheet.

SEC-rules.[152] The Form further requires disclosure – set out in more detail in Regulation S-K – of a variety of other issues, including business, properties, legal proceedings, market risks, disagreements on accounting and financial disclosure, compensation of directors and officers, certain relationships and related transactions.[153]

A key part of the Form is the MD&A, which shall discuss, inter alia, liquidity, capital resources, results of operations, (forms and impact of) off-balance sheet arrangements, business controls and procedures, audit committee, executive compensation, adoption of code of ethics and use of proceeds.[154] Forward-looking statements under certain conditions (e.g. proper identification and meaningful accompanying cautionary statements) are covered by 'safe harbour rules'.[155] After Enron, § 401 of SOx amended § 13 of SEA'34 on disclosure of material off-balance sheet transactions.[156]

4.2 The new EU securities law disclosure rules for EU *issuers*

In contrast to the US system, the EU disclosure system *for issuers* is not a complete standalone securities law system. It does, however, build an extra regulatory layer for issuers on top of the broader 'institutional' accounting and disclosure system of the 4th and 7th Directives that tends to disentangle these from corporate law and internal affairs of the issuer regarding the division of powers and mandatory corporate actions, e.g. adoption by the AGM, payment of distributions, shareholder litigation and 'publication'. Thus the new EU securities law, the disclosure system for issuers, can be singled out as distinct from these corporate law disclosure and accounting rules on which they build. Their market/investor-oriented disclosure and – hence – enforcement mechanisms clearly shift to market transparency and investor protection and compliance with the global accounting standards (IFRS) for *consolidated* (and issuer's single) accounts.[157]

152 § 13 (b)(2)(B)(ii) and § 13 (i) and § 401(a)(i) SOx. See Rule 13a-14 Certification of Disclosure in Annual and Quarterly Reports. Rule 13a-15 Controls and Procedure.

153 Item 303 Regulation S-K, requires management of all registrants to discuss and analyze financial condition and results of operation for full fiscal years. Item 304, disagreements with Accountants on Accounting and Financial Disclosure and Item 402, requires all compensation to be disclosed for 1) a registrant's CEO, 2) the four other most highly compensated executive officers whose total annual salary and bonus exceeded USD 100,000 and 3) directors.

154 Cf P.N. Ploeger and M.F. van Wissen, 'Jaarverslag, OFR, MD&A of MC?', *Tijdschrift voor Jaarrekeningerecht,* 2007, p. 133-140. Regulation S-K, Item 10 (b), Comm. encourages the use of management's projections of future economic developments, See also Item 303 Regulation S-K, see Rule 175 SA and 3b-6, SEA Rules for definition and liability forward looking statements. See § 21E SEA'34 and par. 27 A (a), applicability forward looking statements, par. 27 (A) (b), exclusions, § 27 (A) (c), safe harbour itself, par. 27(A), definitions forward looking statement.

155 § 21E SEA'34, § 21 E (a) (2) for safe harbour rule, § 303-7 Regulation S-K; cf Regulation FD (fair disclosure) for contacts with investors.

156 In January 2004, the Commission adopted amendments to the MD&A to require disclosure of off-balance sheet arrangements. The adoption Release added Item 303 (c) to Regulation S-B, Items 303 (a) (4) and (c) to Regulation S-K, Item 5.E to form 20-F, and General Instruction B(11)to Form 40-F.

157 Eilís Ferran, *Building an EU Securities Market*, Cambridge: Cambridge University Press 2004, p. 130. The EU issuer disclosure regime conforms to the international norm because it is largely designed with a view to improving the accuracy of securities prices in the interest of investor protection and market efficiency. H. Merkt, 'Disclosing Disclosure: Europe's Winding Road to Competitive Standards of Publication of Company-Related Information', in: Klaus J. Hopt, Jaap Winter and Eddy Wymeersch (eds.), *Reforming Company and Takeover Law in Europe*, New York: Oxford University Press, 2004 and Eilís Ferran, *Building an EU Securities Market*, Cambridge: Cambridge University Press 2004.

EU securities regulation emerged as a complete and almost 'federal' EU securities law (uniform regulations and high level harmonization directives). Former directives, and recommendations on admission to listing (1979/80),[158] prospectus (1989),[159] half year reports (1982), transparency (1988) and insider trading (1989), were completely revised and extended into a new body of EU securities law consisting of a series of high level harmonization directives and (uniform) regulations were adopted as will be summarized below.[160] Recently the EC published a report and a consultation document on the harmonization of transparency requirements after the implementation of the Transparency Directives.[161] They introduced mandatory rules on these subjects largely replacing former (self-regulatory) rules of stock exchanges and markets. Public oversight was introduced to be exercised by national supervisory authorities. As in the US, full focus is on initial disclosure upon issue of new securities by means of a prospectus giving full disclosure to be approved by the national supervisory authority and on subsequent continuous disclosure. The prospectus and Transparency Directive establish the regime for initial disclosure when securities are offered to the public or admitted to trading on a securities market, and for periodic financial disclosures by listed issuers.[162] The Market Abuse Directive deals with timely disclosure of price sensitive information by issuers, as well insider dealing and market manipulation more generally.[163] Public oversight was introduced, but not at EU level; the Prospectus, Transparency and Market Abuse Directives assign national securities regulators with supervisory and investigatory powers, they also oblige these regulators to cooperate with each other and to share information.[164] The CESR was founded and aims for facilitating the development of common supervisory standards, practices and philosophical approaches.[165] This Committee is now named the European Securities Market Authority (ESMA).[166] Private enforcement gets less

158 Council Directive 79/279/EEC of 5 March 1979 coordinating the conditions for the admission of securities to official stock exchange listing, OJ 1979 L66/21 ('Admission Directive'), Council Directive 80/390/EEC of 17 March 1980, OJ 1980 No. L100/1 (Listing Particulars Directive'), Regulation of ongoing disclosures by issuers of officially listed shares: Council Directive 82/121/EEC of 15 February 1982, OJ 1982 L48/26 (Interim Reports Directive).

159 Council Directive 89/298/EEC of 27 April 1989, OJ 1989 L124/8 ('Public Offers Directive').

160 The framework for issuer disclosure within the EU is provided by the Prospectus Directive, the Transparency Directive and the Market Abuse Directive. These Directives are supplemented by implementing measures (in EU language, 'Level 2' legislation) that contain more detailed, technical rules to amplify the basic concepts provided for in the primary (or 'Level 1') legislation.

161 EC's Report on the operation of Directive 2004/109/EC on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market, SEC (2010) 611; see also Consultation on Modernisation of the Directive 2004/109/EC (transparency requirements for listed companies).

162 Eilís Ferran, *Building an EU Securities Market*, Cambridge: Cambridge University Press 2004, p. 134.

163 Eilís Ferran, *Building an EU Securities Market*, Cambridge: Cambridge University Press 2004, p. 134.

164 Eilís Ferran, *Building an EU Securities Market*, Cambridge: Cambridge University Press 2004, p. 209.

165 See Eilís Ferran, 'The Regulatory Process for Securities Law-Making in the EU', in: John Armour and Joseph A. McCahery (eds), *After Enron, Improving Corporate Law and Modernising Securities Regulation in Europe and the US*, Oxford: Hart Publications 2006, CESR was formally established by the Commission in June 2001 and comprises representatives form national regulators of Member States. It is responsible for advising the EC on the detailed implementing rules needed to give effect to framework securities laws; given the regulatory expertise of its members, it seems reasonable to assume that is plays a significant behind-the-scenes role in setting the pace for regulatory decision-making.

166 Interim Report on the Activities of the Committee of European Securities Regulators to the European Commission and sent to: the European Parliament (CESR/03-174b, 2003), available through <http://

focus than public enforcement, however it is explicitly assigned to the Member States. See below par. 7.

4.2.1 Initial disclosure

Initial disclosure upon an offering of securities is the subject of the Prospectus Directive (2003)[167] and detailed Commission Regulations thereto.[168] Aiming to ensure investor protection and market efficiency by maximum harmonization,[169] it introduces de facto 'federal' prospectus requirements, public oversight and promoters' liabilities.[170] An offer shall, unless an exemption is available, be unlawful without prior publication of a prospective that has been filed with and approved by the competent national authority and made public (arts. 3, 4, 13-15 Prospectus Directive). The prospectus shall contain all information on the issuer and the securities being offered or admitted to trading on a regulated market that is necessary to enable investors to make an informed decision (art. 5 Prospectus Directive). The minimum information and inclusion of the final price is set out in arts. 7-8 Prospectus Directive. Responsibilities and liabilities are addressed in art. 5(2)(d) and art. 6: persons responsible should declare that the information contained in the document is, to the best of their knowledge, in accordance with the facts and that the prospectus makes no omission likely to affect its import. Issuers shall disclose and file with the competent authority 'a document' that contains or refers to all information that they have published over the preceding 12 months (art. 10).[171] See also art. 11 which allows for incorporation by reference and art. 12 that allows for self-registration (art. 12). No prospectus shall be published until it has been approved by the competent authority of the home Member State; the Netherlands AFM, the German "Bundesanstalt für Finanzdienstleistungsausicht" (BaFin) and the UK FSA. Public enforcement has been left to the Member States; each Member State shall designate a central competent administrative authority responsible for carrying out the obligations provided for in this Directive (art. 21). Private enforcement is left to the Member States, art. 6 (1) Prospectus Directive requires Member States to ensure that responsibility for the information given in a prospectus attaches at least to the issuer or its administra-

www.cesr-eu.org> (accessed May 2004).

167 Directive 2003/71/EC.

168 Commission Regulation 809/2004 implementing the prospectus directive, OJ L 149 of 30.4.2004. The use of a Regulation as legal instrument is important because it leaves no room for interpretation difference upon implementation in the Member States. Eilís Ferran, *Building an EU Securities Market*, Cambridge: Cambridge University Press 2004, p. 140: the detailed disclosure requirements have been based on the IOSCO international disclosure standards for share issues and also build upon the disclosure requirements that applied under previous Directives.

169 Prospectus Directive, Pre-amble, rec. 10.

170 See for literature on the reasons for maximum harmonization amongst others N. Moloney, 'Confidence and Competence: The Conundrum of EC Capital Markets Law', *Journal of Corporate Law* 1, 2004; J.D. Cox, 'Regulatory Duopoly in US Securities Markets', 99 *Columbia Law Review* 1999; J.C. Coffee, 'Racing Towards the Top? The impact of Cross-Listings and Stock Market Competition on International Corporate Governance', 102 *Columbia Law Review* 1757, 1827-8, 2002 and S.J. Choi, 'Assessing Regulatory Responses to Securities Market Globalization', 2 *Theoretical Inquiries in Law* 613, 632-5, 2001. Eilís Ferran, *Building an EU Securities Market*, Cambridge: Cambridge University Press 2004, p. 142 and 143 also refers to this literature.

171 See also art. 11 which allows for incorporation by reference and art. 12 that allows for self-registration (art. 12).

tive, management or supervisory bodies. The Directive also demands that Member States underscore the disclosure obligations with civil liability under private law (art. 6 (2)).

4.2.2 Continuous disclosure (annual financial report)

The requirements for continuous disclosure are for listed issuers also vested in the Stock Exchange Admission Directive[172] and include the obligation to make available to the public, *as soon as possible,* its most recent annual single and consolidated accounts and its last annual report (art. 67), half-year reports and audit declarations (arts. 70-77).

The Transparency Directive (2004)[173] establishes, like the SEA'34 for the US, the EU system for periodic and ongoing disclosure of financial statements for issuers whose securities are already admitted to trading on a regulated market in the EU. The Transparency Directive does not adopt the same maximal approach as the Prospectus Directive, but provides that the home Member State may impose requirements that are more stringent than the directive; but the host Member State may not (art. 3, Transparency Directive). Issuers shall disclose their annual financial report (art. 4 Transparency DIrective), half year and other interim statements (arts. 5 and 6 Transparency Directive). Disclosure documents shall simultaneously be filed with the national competent authority (art. 19 Transparency Directive) as designated (art. 24 Transparency Directive). National authorities shall have all powers necessary for the performance of their function, including requests for information and documents from issuers, for additional disclosure by issuers, suspension/prohibition of trading, monitoring compliance, public announcement of failure to comply, examination of disclosure documents and carring out on-site inspections to verify compliance[174] (art 24 Transparency Directive). Private enforcement and liabilities are left to the Member States (art. 7 Transparency Directive), not excluding rules on internal affairs and corporate actions to be taken.

Ongoing disclosure rules are further required by the Market Abuse Directive (2003),[175] particularly art. 6, requiring issuers to inform the public as soon as possible of inside information which directly concerns the issuer. Inside information is qualified as to be such that 'if

172 Arts. 67, 68, 69 and 70 Stock Exchange Admission Directive. Directive 2001/34/EC, OJ L 184 of 6.7.2001, amended by Directive 2003/6/EC and Directive 2003/71/EC, OJ L 354/64 of 31.12.2003. Though the national authorities will have to approve the listing rules, exchanges are free to compete within the limits as set by EU law in adopting their listing standards.

173 Directive 2004/109/EC on the harmonization of transparency requirements with regard to information about issuers whose securities are admitted to trading on a regulated market, OJ L of 31.12.2004. The Transparency Directive echoes the policy aspirations of the Prospectus Directive with regard to the building of sustained investor confidence and enhanced market efficiency, Transparency Directive, rec. 1.

174 Disclosure by auditors at the request of the authority shall not be a breach of his contract with the issuer (Art. 24-6).

175 Directive 2003/6/EC on insider dealing and market manipulation (market abuse), OJ L 96/16 of 12.4.2003, art. 6. It vested public oversight on admission, suspension and delisting of securities as well as the power to enforce prevailing listing requirements with the competent national authorities (arts. 10-19). It requires the listing particulars for issuers to contain the information necessary to enable investors and their investment advisers to make an informed assessment of the assets and liabilities, financial position, profits and losses, prospects of the issuer and the rights attaching to the listed securities (art. 21).

it were made public, would be likely to have a significant effect on the prices' of – in short – securities and derivatives,[176] however under certain circumstances the issuer may delay the public disclosure of inside information.[177] Also the Takeover Directive demands for disclosure obligations; art. 6 (1) Takeover Directive requires that a decision to make a bid is made public without delay and that an offeror is required to draw up and make public in good time an offer document containing the information necessary to enable the holders of the offeree company's securities to reach a properly informed decision on the bid. Also, art. 8 Takeover Directive requires that Member States shall ensure that a bid is made public in such a way as to ensure market transparency and integrity for the securities of the offeree company, of the offeror or any other company affected by the bid, in particular in order to prevent the publication or dissemination of false or misleading information.[178]

4.2.3 The annual financial report

The key rules of the Transparency Directive concern the 'annual financial report' (art. 4 Transparency Directive). An issuer shall 'make public' such annual financial report[179] at the latest four months after year end. The four-month period limits the period for disclosure, but does not itself require prompt disclosure (as for interim statements).[180] There is however no doubt that it should be disclosed promptly upon its finalization as 'price sensitive

176 Art. 1 sub 1 MAD, 'Inside information' shall mean information of a precise nature which has not been made public, relating, directly or indirectly, to one or more issuers of financial instruments or to one or more financial instruments and which, if it were made public, would be likely to have a significant effect on the price of those financial instruments or on the price of related derivative financial instruments.

177 Art. 6 sub 2 MAD, an issuer may under his own responsibility delay the public the public disclosure of inside information, such as not to prejudice his legitimate interests provided that such omission would not likely to mislead the public and provided that that such omission would not be likely to mislead the public and provided that the issuer is able to ensure the confidentiality of that information. Member States may require that an issuer shall without delay inform the competent authority of the decision to delay the public disclosure of inside information.

178 See Marco Ventorusso, 'The 13th Directive and the contrasts between European and US Takeover Regulation: different (regulatory) means, not so different (political and economic) ends', *Bocconi Legal Studies Research Paper no. 06-07*, October 2005. Comparing US and EU takeover rules Ventorusso concludes that in concept these systems do not differ greatly, especially regarding traffic rules regulating the public bid. Cf also M.J.G.C. Raaijmakers m.m.v. P.A. van der Schee, 'Regulering en handhaving van overnamebiedingen in perspectief', in: M.P. Nieuwe Weme, G. van Sollinge, R.P. ten Have and L.J. Hijmans van den Bergh (eds.), *Handboek Openbaar Bod, Serie Onderneming en Recht*, part 46, Deventer: Kluwer 2008. p. 1125-1174.

179 Regulation (EC) 1606/2002 of the European Parliament and of the Council of 19 July 2002 on the application of international accounting standards has already paved the way for a convergence of financial reporting standards throughout the Community for issuers whose securities are admitted to trading on a regulated market and who are required to prepare consolidated accounts. Thus, a specific regime for security issuers beyond the general system for all companies, as laid down in the Company Law Directives, is already established. This Directive builds on this approach with regard to annual and interim financial reporting, including the principle of providing a true and fair view of an issuer's assets, liabilities, financial position and profit or loss. Transparency Directive, recital 9.

180 Art. 5 TD: issuer shall make public a half-year financial report as soon as possible after the end of that period and (art. 6) an update.

information'.[181] For Example, under Netherlands law, art. 5:25i (2) AFS requires that insider information as defined[182] in art. 5:53 (1) AFS will be disclosed promptly.
The 'annual financial report' contains a) the audited financial statements, b) the MR and c) statements by the persons responsible that to the best of their knowledge the report 'includes a fair review of the development and performance of the business and the position of the issuer and the undertakings included in the consolidation taken as a whole, together with a description of the principal risks and uncertainties they face' (art. 4 sub 1 Transparency Directive). The consolidated accounts shall follow IFRS and the single accounts of the parent shall be included in the financial report (art. 4 sub 3 Transparency Directive). Art. 4 Transparency Directive requires issuers to *prepare* their *consolidated* accounts (showing the issuer and its group together as one economic unity) in conformity with the IFRS.[183] To prevent the complexities of using and explaining different standards for the issuer's *single* and consolidated accounts,[184] art. 5 IAS Regulations allows (but does not require) Member States to permit issuers to prepare their *single* accounts in conformity with IFRS.[185] The audit report shall be disclosed and the MR shall follow art. 46/36 of the 4th and 7th Directives (art, 4 sub 4 and sub 5 Transparency Directive).

The IAS Regulations (2002)[186] introduce IFRS[187] as the accounting standards to be followed by issuers[188] 'with a view to harmonizing the financial information presented by companies referred to in art. 4 in order to ensure a high degree of transparency and comparability of financial statements and hence an efficient functioning of the Community capital market and

181 Art. 67 SE Admission Directive; cf art. 21 TD and art. 6 MAD. Cf par. 430 UK CA., par. 37v, Jahresfinanzbericht, WpHG and par. 37w, Halbjahresfinanzbericht: unverzüglich'; art. 5:25 c, d and m (sub 1) Netherlands Act on Financial Oversight, Parliamentary documents (Tweede Kamer), 2006–2007, 31 093, No. 2.

182 See art. 5:53 AFS.

183 Adopted in accordance with the procedure laid down in art. 6(2) of the IAS Regulation (EC to adopt as EU rules the standards – IFRS – as developed by the IASC. L. van der Tas& P. van der Zanden, 'The International Financial Reporting Standards', in: P.H.J. Essers, T. Raaijmakers, R. Russo, P. van der Schee, L. van der Tas, & P. van der Zanden (Eds.), *The Influence of IAS/IFRS on the CCCTB, Tax Accounting, Disclosure and Corporate Law Accounting Concepts*, Alphen aan den Rijn: Kluwer Law International 2008.

184 Cf art. 4(3) TD.

185 Cf arts. 395 and 397 UK CA (2006); par. 37 y (1) WpHG; art. 2:362 (8) NCC (optional for non-issuers, but only if both and single accounts follow IFRS).

186 Regulation (EC) 1606/2002 on the application of international accounting standards, OJ L 243/1 of 11.9.2002 and 1725/2003 adopting certain international accounting standards, OJ L 111/3 of 17.4.2004.

187 For an extensive review of the creation of IFRS by the IASB, the adoption of IFRS by the EC and procedures for revision and extension of IFRS see L. van der Tas & P. van der Zanden, 'The International Financial Reporting Standards', in: P.H.J. Essers, T. Raaijmakers, R. Russo, P. van der Schee, L. van der Tas & P. van der Zanden (eds.), *The Influence of IAS/IFRS on the CCCTB, Tax Accounting, Disclosure and Corporate Law Accounting Concepts*, Alphen aan den Rijn: Kluwer Law International 2008, p. 1-26. For an analysis of the meaning and impact of IFRS for tax accounting see, P. Essers & R. Russo, 'The Precious Relationship between IAS/IFRS, national tax accounting systems and the CCCTB', in: P.H.J. Essers, T. Raaijmakers, R. Russo, P. van der Schee, L. van der Tas, & P. van der Zanden (eds.), *The Influence of IAS/IFRS on the CCCTB, Tax Accounting, Disclosure and Corporate Law Accounting Concepts*, Alphen aan den Rijn: Kluwer Law International 2008, p. 29-81.

188 Art. 4 IAS Regulation (EC) 1606/2002, OJ L 243/1.

of the Internal Market'.[189] It reflects the globalization of capital and stock markets and trend towards global standards for financial transparency (also 'best practices') in international finance. It is important to note that IFRS to a certain extent may influence tax accounting and thus may contributes to EU uniform standards for tax accounting.[190] IFRS should warrant the use of uniform international standards by issuers which further directs discretionary judgments of the issuer's board and auditor and also – indirectly – of public supervisors and the judiciary in litigation. This also illustrates the shift from classical '*accounting*' of boards for their management and oversight of the business to share- (and other) stakeholders towards uniform 'market disclosure' *by issuers.* The 'annual financial report' of EU issuers thus tends towards a US-style standalone securities law disclosure document. Nevertheless, it remains connected to corporate law accounting. In the US, neither the Revised Model Business Corporation Act, nor, for example, the predominant Delaware General Corporate Law require annual reports to be submitted for approval to (the annual meeting of) shareholders.[191]

The foregoing description and analysis allows us to turn to the conceptual and practical problems that arise if we try to match the new EU securities law disclosure rules with corporate law powers, responsibilities and procedures.

5. Issuers' 'annual financial report' as market-oriented disclosure confronted with 'corporate accounting' rules

The US concept of the annual report (Form 10-K or 20-F) as a *uniform market-oriented and standalone disclosure document* is effectively followed in EU securities law by the introduction (in the Transparency Directive) of the 'annual financial report' that shall be disclosed to the market promptly upon its finalization, irrespective of any other corporate law procedure (e.g. adoption by the AGM) and/or disclosure (with commercial register or similar agency). It contains all essentials: audited single and consolidated accounts, MR and a 'certification' by responsible persons within the issuer's internal organization. As in the US, where annual reports shall be filed with the SEC and disclosed to the market (not published in a commercial register not submitted for approval or adoption by the AGM and therefore also not connected to explicit or implicit discharge),[192] the document shall be made public and filed with

189 L. van der Tas & P. van der Zanden, 'The International Financial Reporting Standards', in: P.H.J. Essers, T. Raaijmakers, R. Russo, P. van der Schee, L. van der Tas & P. van der Zanden (eds.), *The Influence of IAS/IFRS on the CCCTB, Tax Accounting, Disclosure and Corporate Law Accounting Concepts*, Alphen aan den Rijn: Kluwer Law International 2008, p. 1-26.

190 P. Essers & R. Russo, 'The Precious Relationship between IAS/IFRS, national tax accounting systems and the CCCTB', in: P.H.J. Essers, T. Raaijmakers, R. Russo, P. van der Schee, L. van der Tas & P. van der Zanden (eds.), *The Influence of IAS/IFRS on the CCCTB, Tax Accounting, Disclosure and Corporate Law Accounting Concepts*, Alphen aan den Rijn: Kluwer Law International 2008, p. 29-81.

191 Only rules on investigating corporate books and records in case of a proper purpose and disclosure of conflicts of interest are provided for, § 220 DGCL.

192 US: cf § 16.20 RMBCA: 'furnish' accounts to shareholders; summary statements as to audits; Werner F. Ebke, 'Corporate Governance and Auditor Independence: The Battle of the Private Versus the Public

the national supervisory authority. In the US, the document is not a 'corporate governance tool' for shareholders or the AGM in the sense that they have corporate rights and powers in the corporate process from preparing to final approval and disclosure. That evidently does not take away the educative and regulatory (monitoring) functions of the Report for investors nor the means for public and private enforcement with respect to the report as a disclosure document. SOx did not change the system, but strengthened internal oversight, monitoring and compliance procedures as well as auditor's independence with the ultimate objective of enhancing the accuracy of the disclosure document.
The EU system differs in at least three major aspects. First, Member States have not (yet) all embodied the sharp distinction between the securities law objectives as reflected in the concept of the 'annual financial report' of the Transparency Directive and the remaining corporate law procedures and concepts of the 4th and 7th Directives as reflected in their national law. Secondly, the concept of the MR, although a crucial part of the annual financial report, misses a uniform (IFRS) format such as the US MD&A and fits does not completely fit in with the distinction between executive and non-executive members of the board (or SB); the US annual report to shareholders is signed by CEO and CFO, but, for example, a Netherlands report has to be signed by all members of the management board *and* the supervisory board, although the MR is essentially a report of management.[193] Thirdly, this report specifically reflects the increasing use of disclosure as a regulatory tool by national regulators and therefore its content is exposed to emerging differences between Member States which seems not to be the case in the US where the SEC prescribes the rules for the MD&A.

The first element brings me to the problem of how the prevailing disclosure concept of the annual financial report and its constituent parts (single, consolidated accounts, MR and the board statement/persons responsible for the fairness of these documents, audit opinion) matches with the whole preceding 'internal' process of mandatory corporate law, articles of association and 'applicable' national corporate governance codes that reflect the regulatory choices by the EU and national regulators.[194]

Interest', in: G. Ferrarini, K. J. Hopt, J. Winter and E. Wymeersch (eds.), *Reforming Company and Takeover Law in Europe,* New York: Oxford University Press 2004, p. 191.

193 Art. 50b, 4th Dir., MS shall ensure that the members of the administrative, management and supervisory bodies of the company have collectively the duty to ensure that the annual accounts, the annual report and, when provided separately, the corporate governance statement to be provided pursuant to art. 46a are drawn and published in accordance with the requirements of this Directive…; art. 50c, 4th Dir., MS shall ensure that their laws, regulations and administrative provisions on liability apply to the members of the administrative, management and supervisory bodies referred to in art. 50b, at least towards the company, for breach of the duty referred to in art. 50b. Cf. also III.1.2 DCGC for separate annual report of the supervisory board; cf. art. 2: 101 sub 2 NCC.

194 For, inter alia, the division of powers between management and shareholders, the role, powers and core (entrepreneurial) assignment of directors vis-à-vis non-executive directors (supervisory boards), common and distinct accountability, responsibility and ultimate liability of directors and non-executive directors (one or two tier), gate-keeping by auditors and – finally – governmental agencies. In corporate law and practice such rules are reflected in technical and procedural rules on the series of steps to be taken before the final dissemination of the annual financial report: internal control and preparations, final drafting, submission to and discussion with audit committee and auditor, subsequent submission to and 'approval' by full board and supervisory board or non-executive directors, establishment of final and formal 'approval' and signing to also assume responsibility for the completeness and fairness of the financials and the overall view given in the management report, submitting

The second and third elements will reveal the influence of reporting on the internal governance of boards and the exposure to diverging regulatory choices made by national regulators regarding reporting items (and their impact on the issuer's governance), and by that on board supremacy and internal governance in general, leading in some respects to greater exposure to shareholder activism.

5.1 Drafting, approval, adoption, audit and disclosure of annual accounts

To clarify the intertwining concepts of corporate and securities law we now turn to some corporate law procedures with respect to drafting, approval, adoption, audit and disclosure of annual accounts.[195]

Accounting to shareholders and approval/adoption of the accounts by the AGM was for a long time the usual pattern in European corporate law, also in public companies (issuers). It was related to discharge of the board for such accounting and conditional to payment of dividends, since profits have to be established by adoption of the accounts to allow and enable the issuer to pay dividends. In some Member States it still is (German AktG and Netherlands Civil Code (NCC)) in others, like the UK, which resembles the US system, it is not (secs. 414 and 437 UK CA). Art. 48 draft 5th Directive[196] and earlier drafts of the SE Statute required submission of the annual accounts to the AGM. However neither the 4th and 7th Directives nor the IAS Regulations require any such AGM-approval or adoption. Although the 2006-amendments to these directives (arts. 50b/50c 4th Dir. and 36a/36b Dir7) focus on the board's role and tasks by proclaiming *collective duties of the administrative, management and supervisory body* to ensure that the accounts and report are drawn up and published in accordance with the directives *and for issuers* with IFRS, both the use of 'drafting' and 'publishing' and the addition that these bodies 'shall act within the competence assigned to them by national law' clarify that the directives do not seem to preclude adoption/approval of 'draft' accounts by another body corporate (e.g. the AGM). Such a procedure *if applied to issuers* seems to be at odds with the rules and objectives of the disclosure system of the Transparency Directive. These annual accounts shall be audited before they are laid down for (adoption by) the GMS, the audit report identifies the financial reporting framework that has been applied in their preparation;[197] for EU issuers IFRS shall apply, giving the auditors a pretty straightforward guideline in auditing these annual accounts.[198] In recent years, it has become clear that

(laying down) the document for the shareholders and/or the annual general meeting, simultaneous disclosure to market and the public at large, discussion of the document in the AGM and in some jurisdictions even 'adoption' of the accounts (as part of the report), updating auditors opinions and subsequent 'final' corporate law disclosure of the document by filing with the commercial register (or similar agency).

195 L. van der Tas & P. van der Zanden, 'The International Financial Reporting Standards', in: P.H.J. Essers, T. Raaijmakers, R. Russo, P. van der Schee, L. van der Tas & P. van der Zanden (eds.), *The Influence of IAS/IFRS on the CCCTB, Tax Accounting, Disclosure and Corporate Law Accounting Concepts*, Alphen aan den Rijn: Kluwer Law International 2008, p. 1-26.

196 It allowed MS to provide that adoption would be attributed to another organ (supervisory board) to accommodate prevailing national regimes as e.g. German and the Netherlands provisions for large corporations with supervisory boards composed with influence of employee representatives. See art. 2:163 NCC (old) and §§ 172 and 173 AktG.

197 See arts. 51 and 52 4th Dir. and art. 37 7th Dir.

198 Of course interpretation differences under IFRS framework will exist, however as a common framework as such it provides less room for deviance than in previous times when national accounting

the accounting and audit are part of the laws about market regulation and that the further development of rules concerning these subjects are very closely connected to the efforts to create an internal financial market for the EU.[199]

Between drafting, auditing and publication[200] stand the corporate actions of approval/certification, explicit or implicit discharge as well as the securities corporate act of (prompt) disclosure. How – if at all – are these related? Management shall prepare the document and approve the draft that will be submitted for discussion with the audit committee that in turn will advise the board or the SB whether or not to approve. Management and, as the case may be, non-executives (or SB), by their approval, resume collective responsibility for the accounts, including the 'certification' as required in the report; according to Netherlands law all members in evidence thereof shall sign the accounts (art. 2:102 NCC). The Transparency Directive requires statements to be made by the persons responsible within the issuer, whose names and functions shall be clearly indicated, to the effect that 'to the best of their knowledge' the statements prepared in conformity with IFRS 'give a true and fair view' of the assets, liabilities, financial position and profit or loss of the issuer, and the undertakings included in the consolidation taken as a whole and the MR includes a fair view of the development and performance of the business and the position of the issuer, and the undertakings included in the consolidation taken as a whole, together with a description of the principal risks and uncertainties that they face. 'Persons responsible within the issuer' do not refer only – as in par. 302 SOx – to the CEO and CFO explicitly, but necessarily to the *full* board (or management and supervisory board), because of the fact that members of the administrative, management and supervisory bodies of the company have the collective duty to ensure that the annual accounts are drawn up and published in accordance with the 4th and 7th Directives.[201]

systems were applied. See also 8th Directive which joins the idea of one common financial reporting framework and the executing there of also in auditing, see Pre-amble 3, "The lack of a harmonized approach to statutory auditing in the Community was the reason why the Commission proposed, in its 1998 Communication on the statutory audit in the European Union: the way forward, the creation of a Committee on auditing which could develop further action in close cooperation with the accounting profession and MS." See also Preamble 16, "In order to increase comparability between companies applying the same accounting standards, and to enhance public confidence in the audit function, the commission may adopt a common audit report for the audit of annual accounts or consolidated accounts prepared on the basis of approved international accounting standards, unless an appropriate standard for such a report has been adopted at Community level."

199 Peter Nobel, 'Audit Within the Framework of Corporate Governance', in: Klaus J. Hopt and Eddy Wymeersch (eds.), *Capital Markets and Company Law*, New York: Oxford University Press 2003, p. 199-220.

200 Only accounts that are *duly approved* shall be published (as laid down in national law according to the 1st Directive) together with the annual report and the auditors' opinion.

201 art. 50b 4th Dir., MS shall ensure that the members of the administrative, management and supervisory bodies of the company have collectively the duty to ensure that the annual accounts, the annual report and, when provided separately, the corporate governance statement to be provided pursuant to art. 46a are drawn and published in accordance with the requirements of this Directive…; art. 50c 4th Dir., MS shall ensure that their laws, regulations and administrative provisions on liability apply to the members of the administrative, management and supervisory bodies referred to in art. 50b, at least towards the company, for breach of the duty referred to in art. 50b. Cf. also Best practise III.1.2 DCGC for separate annual report of the supervisory board. See also art. 36a, 7th Directive.

Moreover, such responsibility, as following from the 4th and 7th Directives, does not refer *explicitly* to the accounts as *disclosure documents* but rather to the *corporate* accounts: arts. 50b and 50c 4th Directive.[202] This contrasts with art. 4 sub 2 (c) Transparency Directive which underscores the unity of the annual financial report and function as a market disclosure document as a whole by requiring that the annual financial report comprises statements by the persons responsible within the *issuer* that the disclosed information (financial statements and MR) give a true and fair view of the assets, liabilities, financial position and profit or loss of the issuer, and that the MR includes a fair view of the development and performance of the business and the position of the issuer.

As soon as the annual financial report is thus approved and finalized and the auditors' opinion has been received, the document is effectively 'approved' and shall therefore be disclosed promptly to the market (and not be postponed in any way by a later duty to deposit the accounts with the commercial register). It follows that issuers cannot defer this prompt disclosure on the ground that the document (still) has to be 'laid before' or be submitted (as 'draft') to the AGM (to be held several weeks later) for discussion and/or approval/adoption. This document is beyond any doubt to be considered as containing price sensitive information, also in the meaning of the Market Abuse Directive. The corporate law rule that the 'final' accounts shall be deposited with the commercial register therefore cannot defer the securities law requirement of prompt disclosure of the annual report (by publication and filing with the public agency). Let us now have a closer look and test these statements.

5.1.1 Adoption of the accounts

In the UK, the accounts of a PLC are adopted – as in the US – by the board and signed by a director of the company.[203] These will be 'laid before' but not formally adopted by the AGM.[204] The German AktG requires the management of an AG to submit the accounts and report to the SB to be 'prüfed' (reviewed);[205] the SB shall make a report to the AGM (extended with governance items). The AktG *allows* adoption by either the management or supervisory board but the adoption of the accounts that are already 'approved' accounts may be left to the AGM.[206] According to the German Cromme Code (sec. 2.2.1 GCGC), the board submits the annual accounts to the GMS.[207] Netherlands law sticks to the traditional 'accounting'-

202 Secs. 425 (4), 418, 450 (4) and 451 and 451 UK CA 2006. Art. 50b and c 4th Dir., Duty and liability for drawing up and publishing the annual accounts and the annual report, Directive 2006/46/EC, 2:138/139 NCC.

203 Sec.414, UK CA (2006), A company's annual accounts must be approved by the board of directors and signed on behalf of the board by a director of the company.

204 Sec.437, UK CA (2006).

205 §§ 170 and 171 AktG.

206 See §§ 172 and 173 AktG, The AGM resolves anyhow on profit distribution (§ 174 AktG and the schedule of par. 172 AktG)); cf art. 50 4th Dir. and sec. 2.2.1 Deutscher Corporate Governance Codex (Cromme); cf art. 2:105 (1) and art. 2:362 lid 2 (NCC). Note that under Netherlands law distribution of dividends out of profit is held hostage upon adoption by the AGM of the accounts which show that such distribution is permissible (art. 2:105-3 NCC).

207 Sec. 2.2.1 GCGC, The Management Board submits to the General Meeting the Annual Financial Statements and the Consolidated Financial Statements. The General Meeting resolves on the appropriation of net income and the discharge of the acts of the Management Board and of the Supervisory Board. It elects the shareholders' representatives to the Supervisory Board and, as a rule, the auditors.

tradition by requiring that *all* members of both management and SB shall sign the *accounts* and submit these – *also issuers* (!) – to the AGM for adoption (art. 2:101 (2) (3) NCC[208]), not the *MR* which evidently will not be *adopted* by the AGM. Publication by depositing the annual financial report with the commercial register (1st Directive) shall take place *after* adoption.[209]

This (corporate law) 'draft' status, however, does not, in my opinion, defer the *securities law* disclosure duty to promptly disclose the document (including the reports) after its approval (by the boards) in accordance with the market perspective for *issuers* under the combined EU (directives) to promptly disclose ('as soon as possible') their 'annual financial report', *including* the MR, upon its completion, i.e. final approval of the (supervisory) board and audit opinion[210] (art. 4 Transparency Directive; art. 67 Stock Exchange Admission Directive and art. 6 Market Abuse Directive) and to file it simultaneously with the national authority (art.19 Transparency Directive).[211] Hence, a resolution on adoption or (final) approval by the AGM shall – having regard to notice and announcements to be made – only be resolved several weeks later. Under Netherlands law such adoption fixes the profit and hence the condition of payment of any dividends out of that profit. Issuers shall nonetheless promptly disclose their annual financial report upon completion, announce their year results in a press release and at a press conference, usually followed by 'road shows', even though these are technically still 'drafts'. The market absorbs this '*draft*' information and usually the later AGM in this respect passes by as a non-event. If, in the AGM-discussion,[212] new price sensitive information is given, prompt disclosure is required (art. 6 Market Abuse Directive). See also art. 5:25i lid 2 AFS.

A different point is that the *corporate law* 'publication' of the annual financial report with the commercial register (or similar agency) shall take place after AGM adoption.
These observations evidently have consequences for the public oversight on compliance with these rules and annual financial reports as such. See par. 5.1.4. below.

5.1.2 Changes of 'draft' accounts by the AGM?

Some authoritative Netherlands scholars have argued that the AGM, apart from having the power to decide on allocation and distribution of net profits, may *change* the accounts, for example to increase distributable profits or reserves.[213] Also § 173 (3) German AktG

208 Until 2004, the AGM in a 'structure'-company did not *adopt*, but only *approved* the accounts. The supervisory board did *adopt* the accounts.
209 See art. 2:101 sub 1 NCC, this can take 13 months in total.
210 The AGM may only adopt the accounts if the auditor's statement is available (art. 2:393 (6) NCC).
211 Cf. arts 5:24 (4) and 5:25c and 5:25d and 5:25o AFS; Lower House, 2006–2007, 31 093, nr. 2. (for implementing the Transparency Directive); compare sec. 430 (4) UK CA (2006) providing that the annual accounts and reports 'must be available as soon as reasonably practicable' (on the issuers' website) and § 37v WpHG. Note that the competent authority will be the commercial register and the securities supervisor, as the Netherlands AFM.
212 When discussing these documents the BoM and SB will provide all necessary information, unless a 'zwaarwichtig' (weighty) interest of the company prohibit them from doing so (art. 2:107 (2) NCC). As required by art. 2:107(2) NCC, unless a material interest of the company prohibit them.
213 J.J.M. Maeijer, *Asser 2-III Vertegenwoordiging en Rechtspersoon, De Naamloze en de Besloten Vennootschap*, Deventer: Tjeenk Willink 2000, No. 47.

seems to imply that the AGM – *if* empowered to adopt (§§ 172/173 (1) AktG) – may change the accounts. This, however, seems inconceivable and inconsistent if it implied that Board-members – as well as the external auditor that examined the Report – could be forced to accept such changes and assume liability for such changes in 'their' accounts which had been certified by them with their statement and which were prepared with all the required scrutiny, certainly if in their opinion the suggested changes would contravene mandatory standards or the required true and fair view of equity and results, or if that the use of their discretionary power to account under the prevailing standards would be contested under the 'institutional' umbrella by other 'interested parties'.[214] This might occur if payment of dividends were contested, for example by activist investors who want to raise the pay out by changing reserves or cost items. It seems inconsistent and inconceivable to hold the board responsible for a report that it no longer supports.

Key is that their 'certification' as required by art. 4 of the Transparency, covers the whole financial accounts as disclosure document, as is the case for the prospectus. This would become invalid and hence the annual financial report incomplete. The same applies to the external auditor's opinion that effectively no longer refers to the report that was audited. Similarly the public agency assigned with oversight may reject the changed report and may require a restatement. Thus the AGM's power to adopt and change the accounts is at odds with these rules.[215] § 173 (3) AktG provides that the changes to the accounts will only take effect after that a new auditor's statement is delivered to the amended accounts, without reference to the position of management and the supervisory board.
It shows that adoption by the AGM seems to be clearly at odds with securities law principles and objectives that do not allow changes 'at will' but are rather concerned with proper restatement of information in case of reasonable doubt on the correctness of the information provided.

5.1.3 Material events after disclosure of the annual financial report

Events that materially affect the report of the issuer *after* the (securities law) disclosure of that annual financial report will *as such* not itself make the disclosure document incorrect, since the document reflects the situation at the moment of its disclosure. Such 'post balance sheet' events shall be disclosed in subsequent interim reports or – if needed – a separate statement: arts. 5-6 Transparency Directive and art. 6 Market Abuse Directive. This is the procedure in the US and the UK, where the AGM is not involved in the adoption of the accounts. Such submission for adoption to the AGM of (conceptually) '*draft*' accounts reveals a remarkable difference. If the disclosed annual financial report on the day that the AGM is scheduled to adopt that 'draft', would no longer provide a true and fair view of the issuer's situation, management will furnish additional information to the AGM to be taken into account when resolving on the adoption. Remarkably art. 2:362 (6) NCC requires management – as a matter of *corporate* law – if the accounts *after their adoption* prove to seriously deprive the document from giving the required insight, to inform its shareholders

214 See art. 2:447 NCC implementing the Act Supervision Financial Reporting.
215 Cf arts. 2:101(3),105 (3) and 393 (1), (2),(5) and sub 6 NCC.

promptly and file a statement *with the commercial register* (which deviates from the disclosure rules in the AFS) together with an auditor's opinion. Obviously, for issuers the test is whether any further information or restatement requires subsequent disclosure as 'price sensitive information' by means of an incidental press release,[216] also to be filed with the AFM (public agency) according to *securities* law requirements.

5.1.4 Securities law disclosure and corporate law publication

The annual financial report shall, under the 1st Directive 'publication' regime, also be published through filing with the 'registrar' (arts. 47-50a 4th Dir.) *after* adoption by the AGM. One copy thereof, signed by the BoM and SB, shall to be filed (again) with the commercial register.[217] From a securities law perspective this does not add to the disclosure of the annual financial report that already took place after board-approval, although – at least in the Netherlands – the subsequent AGM-resolution to adopt the annual financial report is conditional to payment of dividends (art. 2: 105 sub 3 NCC) and has to be deposited with the Commercial Register. In practice an *updated* auditor's opinion will be required as per that later date which increases the audit costs for the issuer. Again, this separate duty does *not* impede the securities law disclosure duties. It also illustrates how, with respect to the way of 'disclosure', the securities law disclosure (publication and filing with the public agency assigned with oversight) and corporate law deposition of the accounts with the commercial register (or similar agency) differs.

5.2 The management report (US and EU) as part of the disclosure document

As already observed in par. 4, the US securities disclosure system mainly focuses on disclosure to the market and investors to enable them to assess the value of the company and the shares. It also allows monitoring. The US MD&A report underscores this monitoring function for the market and investor community, as do rules on insider transactions, directors' loans or listing requirements on the independency of audit committees. Evidently, information on the issuer's performance also serves investors (and their advisors) to decide whether and how to vote on i.e. board elections or on a merger proposal.

In the EU disclosure system, the management report also reflects the link with traditional internal corporate accounting and disclosure to the public at large. The revised 4th Directive (art. 46a) now requires listed[218] companies (issuers) to include in their annual report a corporate governance statement and to explain if and why they depart from provisions of the applicable national code ('comply or explain'-rule), the rules of which (in different ways and degrees) are related to the internal affairs of the issuer. This theme will be further elaborated in chapter 3. For now, we focus on the role of the MR in the annual financial report as required by the Transparency Directive and – again – the link with traditional corporate accounting.

216 Art. 6 Market Abuse Directive.
217 §§ 441 and 447 UK CA 2006.
218 A company whose securities are admitted to trading on a regulated market within the meaning of art. 4(1), point 14 of Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments.

As set out below, the EU MR (4th Directive) as part of the annual financial report (Transparency Directive) appears not to serve completely as a standalone disclosure document to the market and investors. The report also serves as a catch-all for evolving reporting items on 'self-regulatory' corporate governance codes, corporate law rules, environmental and other non-financial items. Thus, the regulatory use of disclosure in the US and the EU reflects these different aims and means. (This has its consequences on the internal organization of the issuer in general, on the board supremacy and therefore different exposure to shareholder activism, as will be demonstrated in chapter 4.) As mentioned before, against the background of the emerging EU securities regulation, a series of corporate governance codes were introduced in the Member States with a different nature and scope and also enforcement mechanisms which also has been reflected in the exposure to shareholder activism, see the investigation procedure for the Enterprise Chamber. The UK Combined Code is part of the LSE listing rules: delisting by the LSE is the ultimate sanction for non-adherence to the 'comply or explain' principle. In the Netherlands, observance of the Corporate Governance Code is primarily to be assessed by the AGM, but in an investigation procedure before the Enterprise Chamber of the Amsterdam Court of Appeal, principles and best practices tend to be regarded as customary law under the general umbrella of intra-corporate *bona fide* fiduciary duties and authority versus accountability (art. 2:8 NCC). I will further explore this issue in the next chapter.

With respect to the MR three observations have to be explored. First, the MR is distinguished from the accounts in the 4th and 7th Directives, which affects the corporate procedures discussed above (MR by its nature is not adopted by another body corporate). On the other hand, it forms a constituent part of the 'annual financial report' as the integrated disclosure document under art. 4 Transparency Directive. Secondly, the concept of the MR, although a crucial part of the annual financial report (disclosure document), lacks a uniform (IFRS) format like the US MD&A. It does not take into account reporting items from non-executive directors (or supervisory board). Thirdly, the 4th Directive only enumerates a minimum list of items to be addressed in the MR but does not provide for a uniform MR-format (like the US MD&A). This exposes this part of the 'annual financial report' to differences that Member States may create by using disclosure as a regulatory tool. The second and third elements will reveal the influence of reporting on the internal governance of boards and the exposure to diverging regulatory choices made by national regulators regarding reporting items (and their impact on the issuers' governance).

5.2.1 MR: format

The MR again reveals the different approach of the US annual report to shareholders (Form 10-K or 20-F) that contains a fixed statutory format for the MD&A (Item 303 Regulation S-K) as a narrative and backward-looking analysis of the development of the (segments of) business closely connected to the financial statements. Forward-looking statements are nowadays allowed under protection of specific 'safe harbour rules'.[219] Items to be discussed

219 Regulation S-K, Item 10 (b), Comm. encourages the use of management's projections of future economic developments. See also item 303 Regulation S-K, see Rule 175 SA and 3b-6, SEA Rules for

include: liquidity, capital resources, results of operations and (forms and impact of) off-balance sheet arrangements.[220] The 4th Directive distinguishes the MR from the accounts, i.e. the balance sheet, profit & loss account, consolidated accounts and explanatory notes (arts. 46 4th Dir. and art. 367th Dir.). Art. 4(5) Transparency Directive in turn, however, uses the unitary concept of 'annual financial report' to refer to the 'disclosure document' that shall comprise: the audited financial statements, the MR and directors' 'certifications' (which underlines the unity of the document).[221] The items to be addressed in the MR are listed in arts. 46/46a 4th Dir.: the financial situation of the company (issuer), risk analysis and management, societal issues like labour and employment, (compliance with) environmental and ethical standards (business principles) and forward-looking statements (without safe harbour rules). The 2006 amendments added a mandatory corporate governance statement (arts. 46a 4th Dir. and 10 Dir13[222]) and the 'comply or explain' principle with respect to issuers, effectively influencing the internal affairs and governance of issuers by requiring statutory[223] disclosure on compliance with voluntary ('self-regulatory')[224] non-binding corporate governance codes, a single report of the issuer and the 7th Directive consolidated accounts of its group of companies. Note that 'issuers' become a specific class of 'companies' within the 4th Directive and that the EU consciously refrained from amending the Transparency Directive to reflect these specific requirements *for issuers*. This may be explained by the fact that IFRS, constituting the main body of disclosure items and rules for issuers, focusses on the (consolidated) *financial statements only* and does not (yet) address the content of the

definition and liability forward looking statements. See par. 21E SEA'34 and par. 27 A (a), applicability, forward looking statements, § 27 (A) (b), exclusions, § 27 (A) (c), safe harbour itself, § 27 (A), definitions forward looking statement.

220 Cf P.N. Ploeger and M.F. van Wissen, 'Jaarverslag, OFR, MD&A of MC?', *Tijdschrift voor Jaarrekeningenrecht*, 2007, p. 133-140. After Enron, par. 401 of SOx amended par. 13 of '34 Act to provide for disclosure of material off-balance sheet transactions. Item 303 (c) to Regulation S-B, Items 303 (a) (4) and (c) to Regulation S-K, Item 5.E to form 20-F, and General Instruction B(11) to Form 40-F.

221 Cf art. 2(4) TD and art. 5:24 AFS; 'document'.

222 First, art. 46a (2006 amendments) requires *issuers only* to include a corporate governance statement in their report. That statement shall supply information on a) the corporate governance code the company is subject to (as in the US via NYSE and NASDAQ rules and in the UK the Combined Code under the LSE listing rules) or may have voluntarily decided to apply (like the Cromme and Tabaksblat codes in Germany and the Netherlands respectively) and all relevant information about the corporate governance practices applied beyond the requirements under their national law. Secondly, art. 46a (4) includes into the 4th Directive, again *only applicable for issuers,* the corporate governance statements as required by art. 10 of the Takeover Directive (2004/25/EC), including restrictions on transfer of shares, significant shareholdings, special control rights, restrictions on voting rights, agreements between shareholders resulting in restriction of transfer or voting rights, rules for appointment/dismissal board members, change of control contracts, golden parachutes, as well as – finally – unless otherwise available a) rules on the operation and key powers of shareholders' meetings and individual shareholders' rights, b) composition and operation of the administrative, management and supervisory bodies and their committees. Cf § 315 (4) (German) HGB. art. 2:392 (5) NCC; The 'corporate governance statement' may be separated from the MR.

223 Cf. § 1269, corporate governance rules, in part 6 of the Financial Services and Markets Act 2000 (ch.8), insert par. 89O Corporate Governance Rules. UK CA (2006); § 161 AktG and art. 2:391(5) NCC.

224 Note that the UK Combined Code is part of the London Stock Exchange Listing Rules. The UK Combined Code is coupled to the LSE listing rules, but reporting is also compulsory according to sec. 1269 UK CA (2006). German and Netherlands corporate law in general terms require issuers to disclose according to the comply or explain rule their observance of the Code (§ 161 AktG and art. 2:391(5) NCC). The corporate governance statement (art. 46a 4th Dir. and 10 Dir13) may come separately.

MR. The IASB published a draft discussion paper on the Management Commentary (2005)[225] proposing such common standards but it is expectedly to take a long time before these will be adopted by the IASB (and subsequently by the EU). Evidently, such an IFRS model would by its very nature focus on disclosure of the accounts rather than on the substance of corporate internal affairs. Note that the introduction of such an IFRS format for the MR in the present structure would require an amendment of the 4th Dir. either to explicitly refer to that format or to carve out applicability of arts. 46 ff for issuers.

5.2.2 Reporting items for non-executive directors and responsibility for the report

The MR concept further illustrates the friction between the annual financial report (disclosure document) and the corporate law distinction between accounts and MR as discussed in par. 5.1.1 above. The MR by its nature is not subject to approval by the AGM, although it is a) indispensable for assessing the accounts and b) explicitly an integral part of the annual financial report (disclosure document).

Furthermore, the nature of the MR changes to a broader report since *separate* disclosure requirements for NEDs, supervisory boards, audit and other board committees are emerging.[226] The strict division between management and supervision in German law is reflected in a separate report of the SB on its review of the accounts (and report) to the AGM, including governance disclosure (§ 171-2/3 AktG). The German Corporate Governance Code (GCGC) does not deviate substantially from general corporate law. The Netherlands law is less clear. SBs did not report separately and usually 'advised' the AGM to adopt the audited accounts, adding information on changes in their own composition. In corporate practice they now 'report' *separately* on compliance with a number of best practices of the Corporate Governance Code directly addressed to (members of) SBs (for example, independence, meetings, assessments and on its review of and involvement in (also through the audit committee) the drafting and audit of the accounts, see Best Practise III.1.2 DCGC).[227] That report is – at least formally – not part of the MR, although over time it seems likely that they will report in one document, a separate SB-report seems at odds with the unitary concept of the

225 The Discussion Paper (al. A3) defines the MC as "information that accompanies financial statements as part of an entity's financial reporting. It explains the main trends and factors underlying the development, performance and position of the entity's business during the period covered by the financial statements. It also explains the main trends and factors that are likely to affect the entity's future developments, performance and position".

226 Compulsory under art. 41 Dir8 and regulated by national codes and the 2005 EC Recommendations.

227 For, inter alia, the division of powers between management and shareholders, the role, powers and core (entrepreneurial) assignment of directors vis-à-vis non-executive directors (supervisory boards), common and distinct accountability, responsibility and ultimate liability of directors and non-executive directors (one or two tier), gate-keeping by auditors and – finally – governmental agencies. In corporate law and practice such rules are reflected in technical and procedural rules on the series of steps to be taken before the final dissemination of the annual financial report: internal control and preparations, final drafting, submission to and discussion with audit committee and auditor, subsequent submission to and 'approval' by full board and supervisory board or non executive directors, establishment of final and formal 'approval' and signing to also assume responsibility for the completeness and fairness of the financials and the overall view given in the management report, submitting (laying down) the document for the shareholders and/or the AGM, simultaneous disclosure to market and the public at large, discussion of the document in the AGM and in some jurisdictions even 'adoption' of the accounts (as part of the report), updating auditors opinions and subsequent 'final' corporate law disclosure of the document by filing with the commercial register (or similar agency).

annual financial report as disclosed by the issuer. There is also a certain tendency that the one- and two-tier boards[228] are converging,[229] besides the traditional position of the SB as 'gate keepers' *on behalf of investors* and other constituencies, they also seem to function as NEDs in a unitary board,[230] consequently making the MB and SB more jointly accountable for strategy and soon. In the Netherlands, the DCGC illustrates the foregoing by making the SB and management more jointly accountable for strategy, finance and major transactions: these best practices codes and principles generate a self-fulfilling power in preparing the annual financial report but also on the role of the SB, NEDs and audit committee as internal supervisors.[231]
In Germany and the Netherlands, the SB reviews the annual financial report as prepared by management. The SB's review is prepared by the audit committee; the full SB will resolve.[232] Disputes between management, the audit committee and the auditor will by then be resolved so that (in the Netherlands) both BoM and SB-members can sign the financial statements (art. 2:101 (2) NCC) and the auditor give a clean opinion.[233] They thus effectively already assume responsibility for the annual financial report as a whole.[234] The 'certification' of art. 4 Trancparency Directive, however, clearly concerns the annual financial report *as a whole.* This – again – firmly underscores the unitary concept of the report.

Comparing this to art. 50b ff 4th Dir. and art. 36a ff Dir7 reveals that these articles only require the *accounts* to be signed by *all* members of the board (one-tier board structure) or the board of management and supervisory board (for a two-tier board structure). Art 4 Transparency Directive, however, apparently allows 'certain persons' to be designated.

228 Not legally regulated in the Netherlands, but possible through articles of association, see Unilever NV. See also Best Practise III.8 DCGC, one-tier management. See Netherlands proposal on the act introducing possibilty for the choice of one-tier strcture,Wetsvoorstel (Kamerstukken 31 763) tot Wijziging van boek 2 van het Burgerlijk Wetboek in verband met de aanpassing van regels over bestuur en toezicht in de naamloze en besloten vennootschappen.

229 Paul Davies, 'Board Structure in the UK and Germany: Convergence or Continuing Divergence?', *International and comparative corporate law journal 4,* no. 435, 2001

230 Sven Dumoulin, 'De positie van niet-uitvoerend bestuurder in het monistisch bestuursmodel', *Ondernemingsrecht* 2005-8, p. 268, in structure and organization, there are several management and supervisory bodies. This relevates the dichotomy between the one-tier and the two-tier model in the sense that no uniform one-tier or a two-tier model exists. Directors and commissioners, depending on the company in which they operate, are not always in the same positions and do not have always similar taks to perform.L

231 See e.g. Best Practise III.1.8 DCGC; Raaijmakers, Ondernemingsrecht, 2006.

232 As discussed below in some more detail, each of the BoM and SB members will be severally liable for any misleading statements causing damage to shareholders and others (art. 2:139 CC). If the SB agrees on the accounts they will co-sign these documents.

233 Compare § 171 German AktG and § 315 HGB.

234 Although a distinction should be made between financial accounting (subject to statutory audit) and the narrative non-financial part of the MR providing an overall view on the activities of the issuer and forward looking statements secs. 414 ff UK CA (2006) explicitly provide that the *report* is 'approved' by the board and signed by one of the directors. § 172/173 AktG allows adoption of the Jahresabschluss by the management and supervisory board (or AGM). Compare the certification of CEO/CFO of § 302 SOx. Best Practise II.1.4 DCGC requires management to make an 'in control statement' in its report which is not part *of the accounts.*

5.3 Governance influx

Coming back to par 5.2.1 (MR-content), the somewhat hybrid and open-ended character of the report reveals its capability to be used as 'catch-all' for disclosure issues/topics based on the regulatory function for *company law* issues as promoted by the HLG: "Requiring disclosure of information can be a powerful regulatory tool in company law".[235] Thus, issues 'regulated' by 'soft law' show up where EU harmonization (cf the 5th Directive and the EC recommendations) or national legislation (including board composition) did not result in agreement on legislation. The EC refrained from harmonizing substantive governance rules and drafting its own European corporate governance code, but nevertheless inserted certain elements into directives[236] and came forward with its recommendations on NEDs and executive compensation.[237] Disclosure on these items thus serves the regulatory, educative and monitoring functions of disclosure as discussed above. While the US MD&A is merely part of the disclosure document of the issuer as prescribed by the SEC, the EU MR thus may be subject to an influx of diverging national rules and soft law. The regulatory function of disclosure for the report of EU issuers thus seems to show an 'open-ended' sideway, since the content and comparability of MRs depends on national choices made upon implementation, (the development of) different codes (best practices) of 'self-regulatory' committees/bodies and the way these are supported by listing rules and their 'enforcement'.

6 Public oversight on annual financial accounts and reports

The new EU securities law introduced public oversight. The US did so already in the '33 and '34 Acts to underscore the disclosure system with such oversight and enforcement by the SEC.[238] The EU securities markets and market participants, (demutualized) exchanges, issuers, auditors and other market professionals (e.g. analysts) were thus subjected to

235 HLG Nov 2002, ch. p. 33, pt. 3 and the EC, Modernising Company Law and Enhancing Corporate Governance in the European Union – A plan to move forward, COM 2003.

236 E.g., comply or explain rule – art. 46a 4th Dir.; audit committees – art. 37 (appointment statutory auditor) and 41 (audit committee) Dir8; collective responsibility – art. 50b/36a 4th Dir./Dir7).

237 The Commission's 2004 Recommendation on the role of non-executive or supervisory directors and on supervisory board committees (IP/04/1182) aims at improving shareholders' control over executive management by reinforcing the presence of independent directors on boards and board committees. The Commission has now published a report on how Member States apply the recommended standards, which finds that a majority of Member states comply to a large extent with the recommendations, but some weaknesses remain. <http://ec.europa.eu/internal_market/company/directors-remun/index_en.htm> Remuneration is one of the main areas of potential conflicts of interest for executive directors. Excessive remuneration has also emerged as a prominent feature in many corporate fraud scandals. The Commission's 2004 Recommendation on directors' remuneration (IP/04/1183) provides for high standards of disclosure on this issue and recommends greater involvement of shareholders in the decisions relating to remuneration. The Commission has now issued a report on how Member States apply the recommended standards, which finds widespread disclosure of remuneration, but some reluctance to involve shareholders fully in the decision over remuneration policy. <http://ec.europa.eu/internal_market/company/directors-remun/index_en.htm>.

238 Review every three years, audit requirements, i.e. oversight by independent public auditors, market regulation for other market professionals (including auditors, analysts and securities lawyers), penal sanctions, possible disqualification of directors and officers and experts that signed the disclosure documents. (§ 9 '33 Act and § 301 SOx).

public oversight[239] to enhance market integrity and transparency and protect investors. It replaced self-regulation by exchanges,[240] the securities industry and professionals, though mixtures like the UK City Panel still exist. Many rules were 'criminalized' by making non-compliance offences or misdemeanours, thus allowing public enforcement by penal law. Administrative means for the authorities were introduced or extended (fines, orders, suspension of treading, delisting). Public enforcement does, however, not replace 'gate keeping' by independent auditors on the issuer's annual financial report nor private enforcement. As already mentioned, the auditor's independence from management was enlarged to become an independent 'public watch-dog',[241] to enhance their role as independent gate-keeping experts.[242] In the EU, this role was enlarged by the revised 8th Directive.[243] On both sides of the Atlantic, the statutory audit is regarded as a fundamental prerequisite for the proper functioning of the securities and capital markets.[244] No less important are market mechanisms such as investor pressure, which often appears effective in view of the reputational damage that issuers may suffer if they do not respond in a timely and proper manner.[245] These disciplinary forms of oversight and market forces to enhance trust and reliability in the operation of financial markets should be assessed in their mutual relationship and as a whole.[246]

6.1 Public oversight/enforcement in the US

The SEC exercises oversight on firms' mandatory disclosure and may sanction non-observance by issuers. § 12 (J) SEA'34 authorizes the Commission to suspend registration for not more than 12 months, or to revoke registration on a finding that the issuer has failed to comply with any provision of this Act or the administrative remedy in § 15 (c)(4) SEA'34, which authorizes the Commission, if it finds that any person subject to §§ 12, 13, 14, or 15 (d)

239 I do not discuss here the specific rules for and oversight on the banking and insurance industry.

240 Cf Thomas M.J. Möllers, 'Effizienz als Maßstab des Kapitalmarktrechts', *Archiv für die civilistische Praxis*, 2008, p. 1-36.

241 Werner F. Ebke, 'Corporate Governance and Auditor Independence: The Battle of the Private Versus the Public Interest', in: G. Ferrarini, K. J. Hopt, J. Winter and E. Wymeersch (eds.), *Reforming Company and Takeover Law in Europe,* New York: Oxford University Press 2004, p. 182.

242 Art. 22 revised 8th Directive (2006).

243 Introducing, inter alia, public oversight – comparable to the US PCOAB – on approval and withdrawal of auditors and firms, educational standards and qualifications, registration, professional ethics and secrecy, auditing standards and reporting, quality assurance, investigations and proper sanctions on non observance of the standards, the introduction of public oversight and international cooperation. Consequently the audit committee plays a crucial role in the process of drafting, accounting and auditing the accounts and the report.

244 Werner F. Ebke, 'Corporate Governance and Auditor Independence: The Battle of the Private Versus the Public Interest', in: G. Ferrarini, K. J. Hopt, J. Winter and E. Wymeersch (eds.), *Reforming Company and Takeover Law in Europe,* New York: Oxford University Press 2004, p. 514.

245 Cf. Bill W. Bratton and Michael L. Wachter, 'The Case against Shareholder Empowerment', *University of Pennsylvania Law Review*, vol. 158: 653, 2010, these mechanisms also play a role in the responsiveness of issuers' corporate governance systems to the demands of activist shareholders.

246 Thomas M.J. Möllers, 'Effizienz als Maßstab des Kapitalmarktrechts', *Archiv für die civilistische Praxis*, 2008, p. 15.

has failed to comply with any such provision in any material respect, to publish its findings and order compliance.[247]

With respect to disclosure documents that do not meet the statutory requirements, § 21C SEA'34 invests the SEC with the power to institute cease-and-desist proceedings against an alleged wrongdoer. The respondent to such action will be informed before the SEC release is made public. The respondent may agree to and undertake all such measures and actions as are necessary to properly adjust a wrongful disclosure and to agree that this will be disclosed in the SEC Release. Effectively this results in informing the market and (finally) correcting financial statements that were previously disclosed. This procedure completely aligns with the disclosure system of the SEA'34.
The SEC used to review the annual statements of issuers every seven years. That period was reduced to three years by SOx.[248] Similarly, criminal sanctions on white-collar crimes (including disqualification) were made more severe.[249]

6.2 Public oversight and enforcement in the EU

A brief summary illustrates the present scope of EU public oversight. The national authority shall approve prospectuses (art. 13 Prospectus Directive), approve admission to listing (art.11-15 SE Admission Directive),[250] approve listing rules of stock exchanges (art. 35 Stock Exchange Admission Directive) and exercise broad oversight on market abuses by issuers and market professionals and participants (arts. 7 and 11-15 Market Abuse Directive). It shall be informed of a takeover bid, approve the offering circular (arts. 4 and 6 Transparency Directive) and monitor the rules during takeover bids. It also monitors the monitors: entitlement to audit public interest entities and continuous oversight of auditor's professional and ethical standards was assigned to the national authority by the amended 8th Directive.

Public oversight was extended to continuous disclosure of issuers by art. 24 Transparancy Directive,[251] which assigns oversight on compliance with the rules of the directive to a cen-

247 The SEA permits the Commission, in its discretion, to make such investigations as it deems necessary in order to determine whether any person has violated, is violating, or is about to violate that Act (exchange) or any rule issued under the Act, Louis Loss and Joel Seligman, *Fundamentals of Securities Regulation*, New York: Aspen Publishers 2004, 1480; James D. Cox, Robert W. Hillman and Donald Langevoort, *Securities Regulation, Cases and Materials*, 5th edition, New York: Aspen Publishers 2006, p. 810, § 21 (a) (1) SEA'34. An order for a formal investigation under one or more of the statutory provisions is generally preceded by an informal investigation. See also McLucas, Hamill, Shea & Dubow, 'An Overview of Various Procedural Considerations Associated with the Securities and Exchange Commission's Investigative Process', *45 Bus. Law.* 625, 1990, 628. See also § 20 (d) SEA'34 and § 21 (d) SEA;34 for civil monetary penalty, violations for one of the Sec. Acts. See also § 20 (e) SEA'34; Sec. Ex. Act par. 21 (d) (2). Authorize the courts to bar or suspend a person who has violated § 17 (a) (1) SA'33 or § 10 (b) SEA'34 from acting as an officer or director of any issuer that has a class of securities registered under the 1934 Act or that is required to report under § 15 (d).

248 § 408 (c) SOx.

249 Titles IX on White-Collar Crime Penalty Enhancements; Title XI: Corporate Fraud and Accountability.

250 That, in case of non-compliance, may make public that fact (art. 17) or decide to suspend or discontinue listing (art. 18) in which case the issuer may oppose such order by court action (art. 19).

251 With reference to art. 21 of the Prospectus Directive (2003/71/EC).

tral national authority with the power of delegation.[252] All 'regulated information' disclosed by issuers shall be filed simultaneously with the authority (art. 19 Transparancy Directive). This *national* oversight covers compliance by issuers with the global, but – through adoption by the EC – also 'Europeanized', IFRS.
Information shall be disclosed 'in a manner ensuring fast access on a non-discriminatory basis': art. 21 (1) Transparency Directive. Art. 24 (4) Transparency Directive requires proper powers for the authorities on information and investigation, order to disclose, suspension or prohibition of trading securities, monitoring timely information to ensure effective and equal access to the public, disclosure of findings of non-observance ('naming and shaming'), examination that the required information complies with the relevant reporting framework and taking appropriate measures in case of discovered infringements, inspections and examinations and further: appropriate administrative, civil and/or penal penalties (arts. 28-29). To avoid and prevent divergent interpretations, a permanent European Securities Committee has been established to assist the EC. EU-US cooperation will enable this to become more important.[253] Cooperation on oversight between national authorities or those of third countries, important in cases of multiple listings or trading, is the subject of art. 23 Transparancy Directive. The directive does not specifically provide for or exempt authorities from civil liability (see art. 13(6) Prospectus Directive), nor does it regulate jurisdictional conflicts between concurring corporate or court actions by investors to enforce their rights. It may be clear that all these (new/extended) tasks require adequate and high quality staffing of the authorities and continuous monitoring of the regulatory and enforcement mechanisms in the Member States. The costs for these authorities are covered by fees to be paid by the addressees of the oversight.[254]

An important difference with the US remains that the EU, although aiming at integration of the European financial markets has not yet created a European SEC, although CESR (see chapter 5 ESMA) has been assigned a coordinating role. Since public oversight extends to compliance by issuers with IFRS, the dispersion of oversight throughout national authorities does not guarantee uniform interpretation and application thereof even though the European Court of Justice (ECJ) has final jurisdiction in these matters (art. 13 EUTR).
The tension between corporate law accounting and a disentangled market-oriented (continuous) disclosure system remains, also in audit and public oversight.

6.2.1 Restatements

Upon final board approval, the annual financial report contains highly price sensitive information and shall therefore, together with the audit opinion, has to be disclosed 'in a manner ensuring fast access on a non-discriminatory basis'. Such disclosure and professional assessments thereof assure quick absorption by the market (participants). The authority shall oversee such quick market access, equal treatment and prevention of insider

252 FSA (UK), AFM (Netherlands), Bundesanstalt BaFin (Germany).
253 Cf FD 9 April, 2006: Zalm (IASB) expects that by 2013 US firms will be allowed to apply IFRS.
254 Thomas M.J. Möllers, 'Effizienz als Maßstab des Kapitalmarktrechts', *Archiv für die civilistische Praxis*, 2008, p. 15.

trading.[255] If the annual financial report and audit opinion were disclosed in a timely and proper manner but allegedly contain (materially) misleading, incorrect or incomplete statements, public oversight aims at ensuring that the market will be provided as soon as possible with additional information to correct or supplement (restate) the initial 'misleading' information. Alleged misstatements can have different origins: such as a) misapplication of IFRS (e.g. incorrect off-balance accounting, non-consolidation, improper impairments, incorrect valuation of resources, assets and derivatives, incorrect explanatory notes to the accounts), b) misleading figures, or c) incomplete or misleading statements in the MR (e.g. forward-looking statements, environmental risks, labour risks, corporate governance).

Contesting the disclosure document will already *per se* affect the issuer's reputation, its officers and other persons involved in the preparation, audit and/or assessment after disclosure by analysts, rating agencies and others. Private investors may use such allegations as leverage which in court proceedings may be contested and characterized as being 'frivolous' and result in attributing the costs to the plaintiff. Any announcement or rumour of action by the authority will have the same effect. UK CA (2006) explicitly indemnifies the FSA. The Netherlands Wtfv (Act on Financial Reporting), however, reduced this risk by postponing actions of the authority until adoption of the accounts by the AGM and subsequent *judicial* review (art. 2:449 sub 1 NCC). *After* the GMS (art. 2: 447 and 449 NCC) has adopted the annual accounts, the AFM and interested parties have the authority to file a request with the Netherlands Enterprise Chamber to restate the annual accounts the annual report within six months. Cf. also art. 2:452 NCC, which authorizes the AFM to file a request, six months after filing the annual accounts with the AFM, with the Enterprise Chamber to order an issuer to give a further explanation concerning the application of IAS. Remarkably, 2: 454 and 455 NCC give the AFM the power to file a request with the Enterprise Chamber to order an issuer, which is incorporated in another state, to make a public announcement that their annual financial reports/accounts are not in compliance with the requirements of AFS and IAS. This right can be exercised six months after the disclosure of the annual accounts according to art. 5:25c, sub 1 AFS. This procedure is more in accordance with the restatement procedure under US securities law.
The way that the role and responsibility of authorities to require 'correction' of defective annual financial reports have been implemented in various EU MS show remarkable differences and so does comparison with the SEC's powers (par. 6.1. above). Evidently, disputes on the correctness of disclosure documents may also affect the assessment of the statutory audit that was exercised.[256]

6.2.2 Restatement of the annual accounts/report

If reasonable doubts exist as to whether the annual financial report complies with the statutory requirements, (the board of) the issuer shall inform the market whether the effect is material and shall prepare additional information or adjust the accounts and/or report(s)

255 Cf. e.g., secs. 441-453 UK CA (2006).
256 I will not discuss the tension between public oversight on issuers and auditors separately.

that are already disclosed and have this additional or adjusting information audited before disclosure. This voluntary procedure is explicitly foreseen in sec. 454 UK CA (2006).
Absent such voluntarily revision in the UK, the Secretary of State, finding that the published financial report does not comply with reporting standards, may give notice to the issuer and request an explanation or preparing of revisions within one month. If a satisfactory explanation has not been given by then or revisions not been prepared, he may apply to court (sec. 455 UK CA 2006) for a declaration on the alleged non-compliance and an order requiring the directors to prepare revisions. In giving such an order, the court may also give directions on the auditing, the nature of the revision and order directors responsible for the defective reports to pay reasonable expenses (sec. 456 UK CA 2006). Certain qualified third parties may be authorized by the Secretary of State to execute such proceedings (sec. 457 UK CA 2006).

The Netherlands procedure is enacted in Title 16 (arts. 2:447 ff) Book 2 (legal persons) Civil Code, i.e. as part of general corporate law, in the Act on Supervision Financial Reporting (ASFR) and Decree on Supervision Financial Reporting (DSFR). It takes into account the statutory submission for adoption of the annual financial report (of accounts) to the AGM. Before that time, the AFM may request explanations after initial disclosure. If there is serious doubt, the AFM questions may – after due internal process – compel management (SB and audit committee) to provide additional information or restatements. If the issuer refuses or does not respond in a timely and satisfactory way the AFM may recommend the issuer disclose a statement to explain the deficiencies in the annual financial report and the consequences thereof for the report and future disclosure, art. 3 ASFR. This recommendation has to be treated as price sensitive information, art. 2 DSFR. If the issuer still refuses, the AFM may request a judicial order of the Enterprise Chamber of the Amsterdam Court of Appeals to 'correct' the accounts (art. 2:447 NCC).[257] (This procedure does not cover interim statements.) This court action, however, can be brought only *after* adoption of the accounts by the AGM of the issuer, which usually is held several weeks after disclosure of the annual financial report. If the AGM (being informed of the dispute) does *not* adopt the accounts, the AFM can bring such a court action. Note also that any 'interested person' can bring a similar court action, also *without* AFM authorization (unlike in the UK) and even to dissent from a request or 'order' of the AFM.

In Germany, public oversight on annual financial reports *and* intermediate information is invested in the Bundesanstalt (BaFin) (§ 37n Wertpapierhandelsgesetz (WpHG)).[258] It investigates on the basis of concrete indications or at random. Such procedure will be blocked if a *corporate* law action for *annulment* of the annual financial report has been brought (by shareholders) or a *Sonderprüfer* has been appointed (par. 37o-2 (WpHG)). A *Prüfstelle* (§ 342a-e Handelsgesetzbuch (HGB))[259]may inform the *Sonderprüfer* that the issuer refuses to follow

257 Cf P.M. van der Zanden in his annotation of Enterprise Chamber in the case Spijker, LJN BC1057.
258 Cf Thomas M.J. Möllers, 'Effizienz als Maßstab des Kapitalmarktrechts', *Archiv für die civilistische Praxis,* 2008, p. 1-36.
259 According to § 342b HGB the *Prüfstelle* can investigate whether the annual financial report complies with the rules on the ground of concrete indications, at the request of the Bundesanstalt or at random.

its recommendations. In that case, the BaFin can establish – *without* judicial interference – the extend of the shortcomings and order the issuer to announce and disclose these (unless this contrary to the public interest or the interest of the company): § 37q WpHG. This procedure also applies to interim statements. Apparently, the specific 'restatement procedures' as described do not bar the authority from using any other means available.
Both German and Netherlands law show that an action by the public agency (AFM/BaFin) in exercising its oversight from a market perspective and protecting investors is to some extent dependent on or barred by corporate actions (private enforcement); the UK agency is apparently more independent (like the US SEC).

6.2.3 Restatement and liability

A correction *of the accounts* evidently replaces/restates the preceding information. It may initiate securities fraud actions by investors that claim to have been damaged by the initial misleading information or even any kind of derivative suit against (members of) the board or officers. Such actions will be dealt with in more detail in chapter 3.

6.3 Correction of the management report/corporate governance statement

The procedures described do not distinguish between the constituent parts of the annual financial report and therefore are in principle also applicable with respect to defective *reports.* Since the soft law elements thereof, as discussed above, are non-binding, oversight – as with the audit – will be limited to the question of whether – as prescribed – the report discloses which code the issuer has followed and whether the issuer has satisfactorily adhered to the 'comply or explain' rule and thus also properly explained the non-compliance with such soft law rules. Hence, a distinction has to be made between the simple reporting rule as such ('comply or explain') and the principles and best practices' which are addressed and defined in such codes. A court or agency order to 'correct' such statements clearly can only address the former, since addressing the latter would be virtually incompatible with the non-binding nature of these rules. Some observations can be made with regard to the link between securities law disclosure of the report (as constituent part of the annual financial report of the Transparency Directive) and intra corporate law reporting.
First, in those jurisdictions where the AGM has been invested with the power to adopt the accounts, the management report *strict sensu* is not *adopted.* Secondly, insofar as any action to restate is dependent on such adoption or an action for annulment, it is unclear whether and to what extent this bars the powers of the public agency. Thirdly, this reveals the close connection and vague boundary with governance (internal affairs), also with respect to the governance statement as by now required separately by art. 46a 4th Dir. (and art. 10 Takeover Directive).
Again, no major problem arises if the test is limited to whether such statements appropriately reflect the 'comply or explain' rule, although even this test implies a possible review of the internal affairs on 'compliance'. Somewhat more difficult is the test a) whether and to

Such procedure will be blocked if an action for annulment has been brought to annul the accounts or a *Sonderprüfer* has been appointed. The *Prüfstelle* informs the company of its findings and allows a period in which the issuer declares whether he agrees. He reports to the Finanzdienstleistungsaufsicht: § 342b (2) HGB.

what extent a reported adherence to a corporate governance code constitutes (an enforceable) quasi amendment of the articles of association (and/or bylaws or internal regulations) and b) whether and to what extent principles and best practices constitute *per se* customary law that can be enforced. As will be discussed in more detail in chapter 4, these questions have been litigated in substance in the Netherlands in investigation procedures brought before the Enterprise Chamber of the Amsterdam Court of Appeal. This procedure serves, albeit in a very general and open ended way, to achieve 'openness in the corporations' affairs' and may therefore overlap with the specific procedures as described above. Moreover, the Attorney General of the Amsterdam Court of Appeals may also initiate an investigation into the affairs of an issuer 'in the general interest'. It is unclear if such power is barred by an action brought by the AFM or any 'interested person' and an action to *annul* the AGM resolution in which the financial accounts were adopted.
These questions illustrate how securities law disclosure raises further questions as to the demarcation with (and possible extension of) investor protection under corporate law. In chapter 4 this tension will be further elaborated.

6.4 Federal oversight in the EU: need for a European SEC?

The foregoing leads to the question of whether a European SEC is needed to warrant uniform standard setting and interpretation of IFRS and for disclosure of issuer's annual financial reports. I tend to concur with scholars who have argued that the absence of a centralized enforcement authority and in that sense a separation of standard setting and enforcement will lead to a loss of regulatory quality. A European SEC[260] seems to be necessary[261] for achieving such an objective in the perspective of capital market integration.[262] A European SEC could contribute to fostering, developping and administering flexible regulations for the European equity market.[263] It could play an important role in exercising oversight of private sector accounting bodies and participate in the ongoing drafting process of the IASC (IASB), as well as with the US SEC on the convergence of US GAAP and EU IFRS.[264] A European SEC

260 The idea of en ESEC is not new: Hopt argued in 1976 that such an institution should be considered, see K.J. Hopt, 'The necessity of Co-ordinating or Approximating Economic Legislation, or of Supplementing or Replacing it by Community Law-A Report', 13 *Common Market Law Review* 245, 1976 and G. Hertig and R. Lee, 'Four predictions about the future of EU securities regulation', *Journal of Corporate Law Studies* 2003, p. 372.

261 See G. Hertig and R. Lee, 'Four predictions about the future of EU securities regulation', *Journal of Corporate Law Studies* 2003, p. 375. There are good reasons to believe that Member States will not be able to guarantee effective corporate disclosure by EU issuers. In view of the historical comparative opacity of most Member States' accounting standards, it is hard to believe that Member States will be able to guarantee the appropriate transparency of financial statements.

262 Donald C. Langevoort, 'Structuring Securities Regulation in the European Union: Lessons from the US Experience', *ECGI. Law Working Paper Series,* 41/2005, p. 25. I agree with Donald Langevoort that probably practical politics probably stand in the way of the sense of vision expressed by the Treaty of Rome. Langevoort ends his article by saying: "Whether one admires the SEC or not, we should admit that its replication in Europe would not be particularly easy. For better or worse, a European SEC would be a markedly different creature."

263 Roberta S. Karmel, 'The Case for a European Securities Commission', 38 *Colum. J. Transnat'l L.* 9 1999-2000.

264 Roberta S. Karmel, 'The Case for a European Securities Commission', 38 *Colum. J. Transnat'l L.* 9 1999-2000, p. 34.

could also play a role in monitoring of the harmonized annual and periodic disclosures[265] and advise the EC on amendments if market development were to require modernizing such rules. A similar role could be played in clearance and settlement systems and procedures to further an efficient pan-European securities market.[266]

Adequate means for private enforcement should prevent that public enforcement from becoming too bureaucratic and costly.[267] Whether a ESEC is political feasible is another question. Further research is necessary. However, the EC recently reported on the implementation of the Transparency Directive in the MS and proposed the establishment of ESMA.[268] On 24 November 2010, ESMA was introduced by Regulation (EU) 1095/2010.[269] CESR will take over, as appropriate, all existing and ongoing tasks from the CESR (Regulation, art. 8 Regulation).[270]

7 Private enforcement of securities law rules by investors and other interested parties

From public enforcement as described in the preceding paragraph, we now turn to *private* enforcement of the new EU securities regulation, also of disclosure of the annual financial report as the key disclosure document. The securities law directives and regulations leave

265 Roberta S. Karmel, 'The Case for a European Securities Commission', 38 *Colum. J. Transnat'l L.* 9 1999-2000, p. 35 and G. Hertig and R. Lee, 'Four predictions about the future of EU securities regulation', *Journal of Corporate Law Studies* 2003, p. 375.

266 Roberta S. Karmel, 'The Case for a European Securities Commission', 38 *Colum. J. Transnat'l L.* 9 1999-2000p. 32.

267 Roberta S. Karmel, 'The Case for a European Securities Commission', 38 *Colum. J. Transnat'l L.* 9 1999-2000 and G. Hertig and R. Lee, 'Four predictions about the future of EU securities regulation', *Journal of Corporate Law Studies* 2003, p. 376. ESEC intervention should foster private enforcement procedures. Very generally, ESEC intervention will make financial statements, periodic disclosure and ongoing information less opaque, thus making it more difficult to issue misleading statements, or to hide managerial mistakes and blatant discrepancies between compensation and performance. Given increased competitive pressures, which aggravate the consequences of mistakes, and reduced investor tolerance towards managers who fail to deliver, this is likely both to increase investors' willingness to sue, and as well as courts' sympathy for their complaints.

268 See consultation and report of EC on reviewing the execution of the Transparency Directive in the several Member States. The review of the operation of Directive 2004/109/EC: emerging issues Accompanying document to the Report from the Commission to the Council, the European Parliament, the European Economic and Social Committee and the Committee of the Regions Operation of Directive 2004/109/EC on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market COM(2010) and the proposal for the establishment of a ESMA, EC COM (2009) 505 final, Proposal for a Regulation of the European Parliament and of the Council establishing a European Securities and Markets Authority.

269 Regulation (EU) No. 1095/2010 of the European Parliament and of the Council of 24-11-2010, establishing a European Supervisory Authority (European Securities Markets Authority) amending Decision No. 7136/2009/EC and repealing Commission 2009/77/EC.

270 Regulation, art. 76, The Authority shall be considered the legal successor of CESR. By the date of establishment of the Authority, all assets and liabilities and all pending operations of CESR shall be automatically transferred to the Authority. The CESR shall establish a statement showing its closing asset and liability situation as of the date of that transfer. That statement shall be audited and approved by CESR and by the Commission.

and assign such private enforcement[271] to the Member States to fit in with their national legal systems and traditions.

As stated before, in the US the '33 and '34 Acts underscored the disclosure system with private causes of action directly related thereto and focussed on their enforcement: a strict liability for securities fraud.[272] Hence, private enforcement is *not* shaped through any *corporate* action of shareholders, but through the threat of strict liability *of the firm* itself and officers for disseminating misleading information to the market. Its use focussed on insider trading cases.[273] Securities fraud actions are clearly distinguished from (derivative) actions on 'directors' liability'. The concept of discharge is unknown in US law, but such (derivative) actions can be rebutted by the business judgment rule. Corporate state law only plays a role insofar as fiduciary duties are concerned, not in case of an allegation of disclosure of misleading information to the market.[274] SOx did not substantially change these means for *private* enforcement.[275] It rather aimed at enhancing the drafting and disclosure process and oversight on auditors and market professionals in the securities industry.[276] It increased sanctions for non-compliance with internal procedures (certification CEO/CFO; role of the audit committee and position of the auditor,[277] sharpened sanctions, such as, disqualification of directors, and increased sentencing guidelines for punishment[278]). Non-compliance with new governance rules (such as audit committees, independent directors[279]) may lead to suspension or delisting.[280] The main private actions therefore available to investors remain those of the '33 and '34 Acts. Conceptually, prospectus liability of promoters is extended to continuous disclosure under the SEA'34.[281]

271 Art. 6 (1) PD requires Member States to ensure that responsibility for the information given in a prospectus attaches at least to the issuer or its administrative, management or supervisory bodies. The directive also demands Member States to underscore the disclosure obligations with civil liability under private law (art. 6 (2)), see also art. 7 TD.

272 § 10b SEA '34, Rule 10b-5, it shall be unlawful for any person using interstate facilities a) to employ any device, scheme, or artifice to defraud, b) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or, c) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, *in connection with the purchase or sale of any security.*

273 Larry D. Soderquist and Theresa A. Gabaldon, *Securities Law*, New York: Foundation Press 2007, p. 149. Other usage of Rule 10b-5: when a person mismanages a corporation in ways that are connected with the purchase or sale of securities, when a securities firm or another person manipulates the market for a security traded in the over-the-counter market, and, when a securities firm or securities professional engages in certain other forms of conduct connected with the purchase or sale of securities.

274 See Business Roundtable.

275 Not part of state company law but of federal action on securities fraud.

276 Cf the proposals made by, inter alia, Lucian Arye Bebchuk, 'The Case for Increasing Shareholder Power', *Harvard Law Review*, Vol. 118. No. 3, p. 933-914, January 2005.

277 §§ 302, 404 - 408 SOx.

278 SOx, Title VIII.

279 Cf. § 301 SOx and § 10A (m) SEA '34

280 12 (j) SEA'34, and § 801-809 SEA'34.

281 § 11 SA'33, civil liability on the issuer, directors, certain officers, underwriters, accountants, engineers, and other experts, when registration statement contains material misstatements or omits to state material facts. § 12 SA'33, Civil liabilities in connection with prospectuses and communications, par. 12 (a) (1), any person who offers or sells a security in violation of section 5, § 12 (a) (2), imposes civil liability upon any person who offers or sells any security by means of material misstatements or omissions to state material facts. § 10-b SEA'34 and Rule 10b-5.

Looking to the EU a similar distinction between liabilities for initial and continuous disclosure can be perceived. The investor/market-oriented rule art 6. Prospectus Directive requires Member States to ensure that their laws, regulations and administrative procedures on civil liability will apply to persons responsible for the information given in a prospectus. Similarly, art. 7 Transparency Directive requires Member States to ensure that responsibility for the information to be drawn up and made public in accordance with articles 4, 5, 6 and 16 lies at least *with the issuer or* [emphasis added] its administrative, management or supervisory bodies and liability apply to the issuers, the bodies referred to in this article or the persons responsible within the issuers'.
Apart from these securities law provisions, the *amended* 4th and 7th Directives now specifically require Member States to 'ensure that their laws, regulations and administrative provisions on liability apply to the members of [these] administrative, management and supervisory bodies[282] (..) at least *towards* the company'.[283] This wording does not exclude issuers and seems to imply, in the concept and structure of these directives, the corporate law rules on drafting and submission of the accounts to the SB and/or the AGM and the subsequent *corporate* law disclosure. The directives seem to allow two ways of implementation: a) extension of 4th Dir./7 liabilities[284] (being also available to third parties) to *issuers* themselves and b) a separate securities law based integration of liabilities (directed to compensation of damages to investors) to cover both liability for prospectus and subsequent periodical information. In the latter option, liabilities can – in principle – be disconnected from corporate actions (e.g. adoption of the accounts) and any action to annul, amend or reconsider business judgments, actions and resolutions by bodies corporate and related assessment of business judgment rules. Taken together, these different rules do not create a homogenous and integrated disclosure *and enforcement* system in EU securities law (also having regard to the new public oversight).

The foregoing analysis reveals that the classic accounting approach already seeks to invert shareholders (AGM and individually or groups) with powers in the corporate decision-making process with respect to the laying down, discussion and even adoption or approval of the annual accounts (not financial statements). The flipside of this is the principle that those providing accounts duly and properly will in principle be discharged from the execution of

282 Note that issuers (as public interest entity) are required by art. 39 of the amended 8th Directive to have an audit committee.

283 See art. 50b Dir 4, Member States shall ensure that the members of the administrative, management and supervisory bodies of the company have collectively the duty to ensure that the annual accounts, the annual report and, when provided separately, the corporate governance statement to be provided pursuant to art. 46a are drawn up and published in accordance with the requirements of this Directive and, where applicable, in accordance with the international accounting standards adopted in accordance with Regulation (EC) No 1606/2002. Such bodies shall act within the competences assigned to them by national law. Arts. 50c 4th Dir. and 36b Dir7, Member States shall ensure that their laws, regulations and administrative provisions on liability apply to the members of the administrative, management and supervisory bodies referred to in art. 50b, at least towards the company, for breach of the duty referred to in art. 50b.

284 Such '4th Directive liabilities' then – upon implementation in national law – are not limited to nor would they be exclusively guided by a market-oriented approach to protect *investors,* but – in different degrees – intertwined with classical corporate law actions and sanctions.

their tasks and assignment during the reporting period. In some EU Member States, this 'accounting' approach, as explained, still interferes with the new securities law disclosure approach. Specific actions for damages caused by misleading information are embedded in principles of tort law. Specific prospectus liability for promoters was addressed at an early stage, but enforcement of continuous disclosure rules is evolving.
The other perspective of securities law market disclosure and investor protection evidently seeks to address the enforcement mechanisms on misleading or fraudulent information and improper or untimely disclosure as such, with a clear division between initial disclosure (upon issuing new securities in the market: prospectus liability) and continuous disclosure (as long as the issuer's shares are listed/traded).

7.1 Prospectus liability

History shows that abusive offerings of securities were the first to be addressed a.o. with civil liabilities of promoters and others directly involved in and accountable for the prospectus and issue of securities, whilst rules for ongoing disclosure and enforcement developed differently.
The Prospectus Directive and accompanying regulations require a prospectus[285] to contain explicit declarations of the (management and board of the) promoter and other persons (underwriter, experts).[286] These persons shall be clearly identified in the prospectus and shall declare 'that to the best of their knowledge, the information contained in the prospectus is in accordance with the facts and that the prospectus makes no omission likely to affect its impact'.[287] The Member States shall ensure that their rules on civil liability apply to these persons.[288] Enforcement by means of civil liability is thus left to the Member States. They shall ensure that responsibility for the information disseminated in the prospectus attaches 'at least to the issuer or its administrative, management or supervisory board, the offeror (also lead manager) and the person asking for admission to listing. Submission to listing/trading rules underscores this commitment of issuers, be it contractually or otherwise'.[289]
Specific prospectus and liability rules were already introduced in various Member States at an early stage.[290] Differences in private enforcement will occur and these may cause friction with EU ('federal') basic concepts and the framework of the integrated European financial market, and may explain the differences between the EU and the US as well as those amongst Member States. MIFID did not solve these issues neither did the current revised Prospectus Directive.

285 Directive 2003/71/EC, art. 13 (to be approved by the competent authority).
286 Issuers shall disclose and file with the competent authority 'a document' that contains or refers to all information that they have published over the preceding 12 months (art. 10) Self-registration is possible (art. 12), Directive 2003/71/EC, art. 13.
287 Art. 6 (1) Dir. 2003/71/EC.
288 Art. 6 (2) Dir. 2003/71/EC.
289 Special study on market structure, listing standards and corporate governance, American Bar Association, *The Business Lawyer*, August 2002.
290 In 1928 in the Netherlands. The Gladstonian reforms in the second half of the 19th century introduced disclosure rules to cope with the moral hazard of promoters and prevention of abuses in an IPO. These rules sometimes were extended to other disclosures: e.g. arts 2:139 and 6:194-196 NCC.

7.2 Liability for misleading information/continuous disclosure

As stated earlier, apart from the availability of 'securities fraud' actions for misleading initial and continuous disclosure, the 4th and 7th Directives require Member States to provide for liability of board and officers *vis-à-vis the company itself.* This evidently is again linked to corporate law and therefore also in this respect national regulations do differ.

For the UK, sec. 463 (2) CA (2006) provides that a director of a company is liable to compensate *the company* for any loss suffered *by it* as a result of any (knowingly) untrue or misleading statement in a report or an omission from a report required to be included. This only applies to 'reports'; no person shall be subject to any liability *other than the company* resulting from reliance, by that person or another, on information in such a report.

German securities law provides in § 37b/37c WpHG for a cause of action to recover damages caused by non-compliance of duties to disclose insider information and disclosure of untrue insider information. The Kapitalanleger-Musterverfahrensgesetz (KapMuG) allows for collective action of securities law claims for damages caused by false, misleading or omitted disclosure duties, in annual financial reports and interim statements (§ 1/2 KapMuG). I memorize that the annual financial report of an AG (also issuer) will be null and void if drafted such that if its content violates rules that have been given exclusively or predominantly to protect the creditors of the company (§ 256 AktG). This fact can be established by the court at the request of investors that were shareholders at the time that the report was adopted, but also by the management board and individual members thereof (§ 256-7 and 245 AktG).[291] Cf the general rules for directors' liability for improper execution of an assignment: par. 93(2) and the German variant of the business judgment rule in par. 93(1) AktG. This action can – if agreed by a majority of the GMS – be brought as a derivative action (§ 147 and 148 AktG). Art. 2:139 NCC for the Netherlands provides that all directors (note: *not the issuer*) will be jointly and severally liable vis-à-vis *third parties* (creditors and shareholders), if the annual accounts or intermediate statements disclosed by the company have given a misleading picture of the situation of the company, for the damages thereby suffered, unless a director proves that he is not to blame. Art. 2:138 NCC provide that directors will be held liable for the company's deficit *in bankruptcy* if the annual financial report was not published (in a timely manner). The general rules applicable in case of 'securities fraud' are given in arts. 6:194-196 NCC under the umbrella of misleading 'advertisements' for prospectus liability; especially art. 6:193a NCC and further; misleading information under continuous disclosure obligations will be addressed/redressed in the Netherlands on the basis of a general tort law action for damages.[292] If in an investigation procedure 'mismanagement' has been established on the ground of improper or misleading disclosure of materials, this fact may be a cause for a subsequent action on liability of directors.[293] The

291 § 256 (7) AktG, BaFin also has the authority to rescind the already adopted annual financial report in case of a listed public corporation.

292 Art. 6:162 NCC, in case of intent of gross negligence, board members can be liable for misleading statements: Netherlands Supreme Court 25 November 1927, NJ 1928, 364 (Kretschmar/Mendes de Leon). See also the dissertation by S.N. de Valk, *Aansprakelijkheid van Leidinggevenden*, Uitgave van wege het Instituut voor ondernemingsrecht, Kluwer: Deventer 20009, p. 129.

293 The facts uncovered by the investigation procedure leading to the judgment of mismanagement of the legal entity and possible keeping the directors responsible, can be used in general tort action (art. 6:162 NCC).

Act Collective Settlement of Mass Damages inserted in arts. 7:907-910 NCC and 1013-1018 Netherlands Code on Legal Procedure allows a settlement between a tort feasor and a legal entity representative for the collectivity (class) of claimants (injured persons) to be declared binding for the whole class. The legal entity can use art. 3:305a NCC to file a claim for the class which can result in the aforementioned settlement. This procedure may also be used by investors claiming damages in cases of 'securities fraud'. In the Netherlands the *Dexia and Shell*[294] case was one of the first in which the Netherlands Court declared a settlement binding for a whole class.[295]

The general liability for 'improper management' rests on art. 2:9 NCC, which does not provide for a business judgment rule defence.

7.3 The flipside of approval and disclosure of the annual financial report as the key disclosure under the new EU securities regulation: discharge and business judgment

I have argued that the key element of the new EU securities regulation is the disclosure of the annual financial report as a whole, including the 'certification' statement by directors. I further argued that corporate procedures and actions to submit accounts for adoption to the AGM is at odds with this EU principle and that the focus of private enforcement is developing towards European forms of securities fraud actions.

Germany and the Netherlands are familiar with the concept of discharge as a general rebuttal in litigation for personal liability of directors.[296] Here, however, my starting observations of this paragraph are illustrated since this concept is embedded in classic corporate law and decision-making in the setting of 'accounting'. Both jurisdictions envisage, in different ways, the power of the AGM to resolve to discharge management and supervisors from the execution of their assignment in the reporting period. This links such a resolution to the discussion and approval/adoption of the annual financial report.[297] This is, as discussed above, not the case in the US. Under UK law, the report is only laid before the AGM, allowing discussion but not requiring adoption or approval. Netherlands law explicitly requires adoption *of the accounts* (only) by the AGM and German law gives the option that the (complete) 'Jahres-

294 The Amstedam Court of Appeal declared in 2009 a settlement concerning the oil reserve scandal between Shell corporation and a foundation binding, Amsterdam Court of Appeal 29 May 2009, LJN BI5744 (Shell).

295 See for some Netherlands literature on this 'new' Netherlands device, I.N. Tzankova, 'Enkele overpeinzingen naar aanleiding van de Dexia-beschikking', *Ondernemingsrecht* 2007, 88, in which she provides some convincing arguments why under the Netherlands regulation e.g. US fear for 'sweetheart settlements' as prevailing under their system is ungrounded: e.g. the involvement of sufficient powerful and experienced 'lead plaintiffs'. Cf also A.F.J.A. Leijten, 'De betekenis van de Wet Collectieve Afwikkeling Massaschade voor corporate litigation', *Ondernemingsrecht* 2005, 176.

296 Discharge is acceptance by the assignor (or his representative) of the accounting by the assignee(s), i.e. in a corporation: discharge of management (board) by the corporation (represented by another body corporate: AGM, SB or NEDs) and thereby releasing them in principle from liability, albeit with certain limitations as set out below. This resembles the position of a trustee vis-à-vis the beneficiaries.

297 I memorize a) that adoption by the AGM (as in the Netherlands and – optionally – in Germany) is not an EU requirement , b) that also adoption by the SB (Germany) or the board (UK) is not foreclosed and c) that the same holds for any corporate resolution and the (degree of) defence offered thereby to discharge (members) of the (supervisory) board.

abschluss' be approved by the Vorstand/SB or the AGM. In the latter jurisdictions therefore the question is whether and to what extent adoption or approval discharges management (and SB) from 'accounting' to the resolving corporate body and its consequent legal effect.

In the Netherlands, adoption of the accounts by the AGM was long regarded as 'acceptance' of the 'accounting' by the directors (as 'agents') and thereby also as discharge of board members from the performance of the tasks attributed to them by statute and articles of association. Such discharge was usually in the articles of association assumed to have been given by such an AGM resolution, but standing case law prohibited the use thereof as a defence in a law suit against directors for misleading or incomplete statements.

In 2004, art. 2:101 (3) NCC explicitly disconnected adoption (by the AGM) of the accounts from such discharge. Hence, discharge requires separate AGM resolutions and the Corporate Governance Code makes a further split between management and supervisory board.[298] So, the accounts may be adopted (the report is not) and at the same time discharge of managers and/or SB members withheld. This may signal a desire for policy changes. If so deprived from discharge, no alternative statutory business judgment rule protects management and SB in a later suit for liability which also may follow an investigation procedure, in which case, mismanagement of the company may be established on non-compliance with best practices of the Corporate Governance Code. These threats and the reputational damage involved may increase risk-aversion conduct. This will be elaborated on in chapter 4.

Comparison with German law shows that according to § 120 AktG, the AGM each year resolves on the discharge (Entlastung) of managers and supervisory board members which resolution "billigt der Verwaltung der Gesellschaft", but does not result in a waiver for a claim for compensation ("enthält kein Verzicht auf Ersatzansprüche"). Such claims can be litigated under the general provision on directors' liability (§§ 93 and 116 AktG), also as a derivative suit (§§ 148-149 AktG). The German legislator apparently did observe the disconnection of the concept of discharge from the new securities law and did indeed introduce a new business judgment rule in § 93 AktG. "*Eine Pflichtverletzung liegt nicht vor, wenn das Vorstandsmitglied bei einer internehmerischen Entscheidung vernünftigerweise annehmen dürfte, auf der Grundlage angemessener Information zum Wohle der Gesellschaft zu handelen.*"
The Netherlands does not have a similar business judgment rule[299] to shield claims, irrespective their (in)-effectiveness in an action for securities fraud. Nor are there statutory

298 Best Practice IV.1.6 DCGC.

299 § 8.31 (a)(2) MBCA, directors are not liable to the corporation or its shareholders for any decision, unless, challenged conduct consisted or was the result of: i) action not in good faith; or (ii) a decision (a) which the director not reasonable believe to be in the best interest of the corporation, or (b), as to which director was not informed to an extent the director reasonably believed appropriate in the circumstances; or (iii) a lack of objectivity due to the director's self-interest. (iv), a sustained failure of the director to devote attention to ongoing oversight of the business and affairs of the corporation (v), receipt of financial benefit to which the director was not entitled or any other breach of director's duty of loyalty. See also § 102 (b) (7) DGCL. Cf § 93(1) AktG: 'Die Vorstandsmitglieder haben bei ihrer Geschäftsführing die Sorgfalt eines ordentlichten und gewissenhaften Geschäftsleiters anzuwenden. Eine Pflichtverletzung liegt nicht vor, wenn das Vorstandsmitglied bei einer unternehmerischen Ent-

provisions on indemnification as in the US. UK's case law tends towards the development of a BJR.[300]

7.4 Private enforcement and the corporate procedure of finalization of the annual financial report/accounts and restatements

I already questioned the consistency thereof taking into account the different status of the management report that is – at least in a technical legal sense – not 'adopted'. Such adoption requires proper corporate action, here: a proper discussion[301] of this item on the AGM agenda and a proper AGM resolution. This seems inconceivable and inconsistent[302] if it implied that board members could be forced to accept such changes and assume liability for such changes in 'their' accounts.
The classical enforcement tool is a court action to *annul* the corporate resolution to adopt the accounts (as recorded in the minutes) on general corporate law grounds. The grounds may vary from abuse of majority power (for example, resulting in retaining profits and decreased pay out) to incorrect application of accounting standards. Note that for the Netherlands, adoption of the accounts is a condition of legitimate payment of dividends from profit (or distributable reserves) as evidenced in the accounts.[303] See for actions for annulment Germany: §§ 256 and 257 jo 243 AktG and for the Netherlands: arts. 2:15 and 447 ff NCC. The latter procedure shall be directed to 'correction' rather than annulment of *already adopted* accounts and be limited to the grounds that – in short – IFRS has not been properly applied.[304] The UK CA (2006) does not envisage an action to annul (the resolution to adopt) the financial report, but rather a revision ('restatement'): sec. 454 ff CA (2006), primarily by *public* enforcement (to allow quick availability of such restatements to the market to allow proper pricing). This is also the purpose of the new German and Netherlands rules on *public* enforcement, which especially in the Netherlands, is connected to adoption of the annual accounts.

In the UK and the Netherlands, *private* actions for such 'restatement' can also be initiated by investors and *any interested party.*[305] In the UK, the plaintiff needs approval by the Secretary

scheidung vernüftigerweise annehmen dürfte, auf der Grundlage angemessener Information zum Wohle der Gesellschaft zu handeln.'

300 Gower and Davies, Principles of Modern Company Law, Sweet & Maxwell, London: 2008

301 Cf. § 243(4) Aktg; no audit-certification; role of auditor in GMS; Tabaksblat and Wta (Act on supervision on auditors).

302 The Netherlands Social Economic Council advised that the authority to adopt the annual accounts would be transferred in 'structuurvennootschappen' to the general meeting of shareholders in stead of the supervisory board. The Social Economic Council considered that it would not match with our system if the GMS had the right to change the accounts. The GMS only has the choice between adopting or not adopting the annual accounts.

303 See art. 2:105 sub 1 and 3 NCC and Best Practise IV.1.4 DCGC, the policy concerning dividends has to be put on the agenda for AGM. See Germany Best Practice, § 119 and 174 AktG. This requirement does not exist in the US.

304 As opposed to the way the competent authority can require and enforce a restatement (and then may include questions of interpretation of IFRS and, in case of multiple listings, also of US GAAP).

305 Addressees of disclosure: consumers or professionals, see H. Merkt, 'Disclosing Disclosure: Europe's Winding Road to Competitive Standards of Publication of Company-Related Information', in: Klaus J.

of State (secs 456/457 UK CA 2006). In the Netherlands, there is no such limitation (arts. 2:447/448 NCC).

It is expected that the focus will shift towards assessment of the correctness of the annual financial report within the decreasing limits of managerial discretion in the application of IFRS. The connection to corporate law procedure of adoption and finalization of the financial annual report/accounts and enforcement and means for restatements shows the tension involved in enforcing market-oriented substantive rules. The request for a restatement has to be filed in the Netherlands two months *after* the adoption of the annual accounts.[306] By then the issuer will supposedly have made a disclosure required by the Transparency, Market Abuse and Stock Admission Directives. Although adoption of the annual accounts/report includes implicit or explicit discharge of the directors, the question remains as to whether, and if so how, *ex post* liability of the issuer and its directors and officers for misleading annual and intermediate reports has to be addressed.

8 Summary disclosure and accounting

The new EU securities law created by a series of directives and regulations focuses on initial and continuous disclosure rules for issuers equally directed at market transparency and investor protection under public oversight by national authorities. The new EU securities disclosure system resembles the US disclosure system, which since its inception in 1933/1934 is characterized by strict initial and continuous disclosure rules for issuers. Directed at market transparency and investor protection, these rules have a standalone character distinct from corporate law (and tax accounting). Their function is to protect investors, not the interests of creditors and other stakeholders of issuers. The SEC is assigned public oversight, additional rule making powers and public enforcement. Private enforcement is facilitated by securities fraud actions. The SOx (2003) sharpened the rules but did not change the system.

EU law is implemented into the national law of the Member States. It replaced the former self-regulatory listing rules set by stock exchanges and financial markets with strict mandatory securities regulation. The core of the new EU continuous disclosure rules is the issuer's annual financial report consisting of its annual accounts, MR and a certification of its responsible persons, who provide a true and fair view. To allow comparability and standardization of disclosure documents, the issuer's *consolidated* accounts shall be drafted in accordance with IFRS. Like the US report to shareholders (10K-20F), this annual financial report effectively serves as a standalone market- and investor-oriented disclosure document.

Hopt, Jaap Winter and Eddy Wymeersch (eds.), *Reforming Company and Takeover Law in Europe*, New York: Oxford University Press, 2004, p. 138.

306 Art. 2:449 lid 1 NCC.The UK restatement procedure seems to have a broader scope including any summary financial statement.

However, these securities law rules and the annual financial report also build on and remain connected with the parallel *corporate* law accounting and disclosure rules of the 1st, 4th and 7th *company* law Directives that apply to *all* (close *and* publicly held) *companies.* These provide mandatory stakeholder-oriented rules for single and consolidated accounts with own accounting, audit and 'disclosure' rules.
I observe that not all Member States have (yet) embodied the sharp distinction between the securities law objectives as reflected in the concept of the 'annual financial report' of the Transparency directive and the remaining corporate law procedures and concepts of the 4th and 7th Directives as reflected in their national law. The corporate procedures and actions to submit annual accounts for adoption to the AGM (as in the Netherlands, as the default rule in Germany, but not in the UK) is at odds with the standalone securities law disclosure character of the annual financial report (art. 4 Transparency DIrective). The connection with corporate law procedure of adoption and finalization of the financial annual report/accounts and enforcement and means for restatements shows the tension involved in enforcing market-oriented substantive rules. The request for a restatement has to be filed in the Netherlands two months *after* the adoption of the annual accounts. By then, the issuer will probably have made a disclosure required by the Transparency, Market Abuse and Stock Admission Directives. Although adoption of the annual accounts/report includes implicit or explicit discharge of the directors, the question remains as to whether and if so how *ex post* liability of the issuer and its directors and officers for misleading annual and intermediate reports has to be addressed.

The concept of the MR, although a crucial part of the annual financial report, misses a uniform (IFRS) format such as the US MD&A and does not match completely with the distinction between executive and non-executive members of the board (or SB). Specifically, this report reflects the increasing use of disclosure as a regulatory tool by national regulators and therefore its content is exposed to emerging differences between Member States, which seems not to be the case in the US where the SEC prescribes the rules for the MD&A.

Being left to the Member States, public and private enforcement of these combined and entangled new rules reveales remarkable differences. The way that the role and responsibility of authorities to require 'correction' of defective annual financial reports have been implemented shows remarkable differences and so does comparison with the SEC's powers. Evidently, disputes on the correctness of disclosure documents may also affect the assessment of the statutory audit that was exercised. An important difference with the US remains that the EU, although aiming at integration of the European financial markets has not yet created a European SEC, although CESR has been assigned a coordinating role (now ESMA). Since public oversight extends to compliance by issuers with IFRS, the dispersion of oversight among national authorities does not guarantee uniform interpretation and application thereof, even though the ECJ has final jurisdiction in these matters.

Private enforcement of the new EU securities regulation, also of disclosure of the annual financial report as the key disclosure document, is left to the Member States to fit into their national legal systems and traditions. My analysis reveals that the classic accounting approach already seeks to invest shareholders (the AGM, and individually or in groups) with powers in the corporate decision-making process with respect to the laying down, discussion and even adoption or approval. The flipside of this is the principle that those providing accounts duly and properly will be discharged from the execution of their tasks and assignment during the reporting period. This approach, as observed, still characterizes the law in some EU jurisdictions. Specific actions for damages caused by misleading information are embedded in principles of tort law. Specific prospectus liability for promoters was addressed at an early stage, but enforcement of continuous disclosure rules is evolving.

It is expected that the focus will shift towards assessment of the correctness of the annual financial report within the decreasing limits of managerial discretion in the application of IFRS.

3

Investor protection in *corporate* law: shareholders rights and board supremacy in the ‘internal affairs’ of issuers

3.1 The End of Corporate History Revisited: towards a common regulatory framework for issuers?

In the Introduction, I briefly referred to the famous article by Hansman and Kraakman on the end of corporate history. They claimed the dominance of the corporate ideology of shareholder primacy leads to major jurisdictions adopting similar rules of corporate law and practice. Their claim in a certain sense illustrates a school in corporate governance observing and forecasting convergence of corporate governance systems all adopting shareholder primacy as the best model to generate most value for the corporation and its shareholders, keeping directors' interests aligned to shareholders. Their approach essentially follows the analysis of the 'agency theory' as developed in law and economics literature: shareholders are 'principals', 'residual/ultimate claimants' and 'owners' of the corporation, the corporation's board (members) and officers being aligned to the shareholder's interests. Shareholder orientation and the hegemony of the shareholders model would eventually replace 'employee' and 'state orientation'. Then the internet bubble burst and corporate scandals erupted. Remarkably, the regulatory responses on both sides of the ocean differed substantially putting the aforementioned claim in a different perspective.[307] US securities law was amended to enhance financial disclosure by the SOx but the prevailing principle of board supremacy and division of powers in the internal affairs of US issuers remained, at least conceptually, unchanged. In contrast, the EU did not limit itself – as did SOx in the US – to building on the basics of the then emerging EU securities law as discussed in chapter 2, although it accelerated the regulatory FSAP process. Both at the level of the EU and of its Member States, discussions and, hence, regulation focussed on enhancing corporate governance by means of corporate governance codes, amendments of corporate law and new case law resulting in a shift of powers in the internal affairs of issuers by rules on oversight by non-executive directors, powers of the AGM and of individual shareholders, the role of independent auditors, the relationship and 'dialogue' between issuers and their investors, executive compensation and the mechanics of the market for corporate control. The introduction of the EU securities law neither stopped nor channelled the debate. The increasing shareholder activism again illustrated that law matters. The developments also showed that relevant law did not converge, but rather took different routes on both sides of the Atlantic. If we look from the perspective of issuers, the question can be raised as to whether and to what extent their internal affairs do indeed converge, especially if we focus on the supremacy and discretion of the board. My hypothesis is that a closer analysis will reveal remarkable differences between issuers in the US, EU and its Member States. Although there is more than one good reason to extend the research to other areas as well, this will be limited to these two markets.

307 John C. Coffee Sr., 'A Theory of Corporate Scandals: Why the US and Europe Differ', in: John Armour and Joseph McCahery (eds.), *After Enron, Improving Corporate Law and Modernising Securities Regulation in Europe and the US*, Oxford and Portland: Oregon 2006.

3.1.1 Unification of EU securities law but different regulatory framework for issuers

What puzzled me most was that apart from the emerging 'federal' EU securities law and the growing influence of (institutional and other) investors, the European Commission in its 2003 response to the 2002 Report of the High Level Group of Company Law Experts, seemed to deviate from its FSAP agenda and did not concentrate on enhancing the emerging EU securities law. EU/MS responses seemed rather to return to *corporate* law responses by amending EU directives and recommendations on corporate governance issues (internal affairs) and on national level by amending corporate law (see the Netherlands' strengthening of shareholder rights). At the same time a series of 'self-regulatory' codes of best practices were (further) elaborated containing both principles and best practices in the realm of corporate (e.g. on NEDs, corporate actions, board assignment, board committees) as well as in that of securities law (e.g. extension of disclosure items). Issuers were confronted both with a new EU body of securities law as analysed in chapter 2 as well as extension of shareholders rights that seemed to erode the principle of board supremacy, not the least by the draft 13th Directive as well as with a variety of non-binding and mandatory provisions regulating their internal affairs.

Therefore, in hindsight, Hansmann and Kraakman seem to have been right in their 2003 analysis that at that time also EU public corporations (issuers) were moving to (increasing) shareholder orientation, but they apparently did not foresee that the simultaneous introduction of a US-like securities law and extension of the powers of shareholders and their enforcement could result in a considerable intrusion of the internal affairs of issuers to the extent of eroding the principle of board supremacy in managing the issuers' affairs. In the following years such erosion seemed to emerge particularly in the Netherlands where in some major law suits (activist) investors successfully challenged large issuers' board supremacy and discretion in the pursuit of the issuers' strategy and policies. This can be explained by some coinciding factors: growing pressure of financial markets and investors especially in the direction of enhancing the market for corporate control, early reactions of the legislator to renew the rules for takeover bids and extension of shareholders rights, the introduction of a bill – in advance of a definitive 13th EU Directive – to limit anti-takeover defences, the introduction of (first) a set of recommendations on corporate governance and followed (after the outbreak of 'Enronitis') by a full Netherlands Code on Corporate Governance, together with the then emerging renewal of securities law and introduction of public oversight. In these circumstances the very broad powers of the Amsterdam Court of Appeals' Enterprise Chamber in an investigation procedure (including assessment of '(mis)management') were applied to the principle of board supremacy and discretion. And although the Supreme Court in several cases reversed such judgements, the practical impact on issuers confronted with requests for changes of strategy and policies (including but not limited to break up scenarios) remained (the rights of inquiry as regulated in Title 8 of Book 2 Netherlands Civil Code will be analysed in chapter 4).

3.1.2 Common securities law and substantial differences in governance of US and EU issuers?

That differs sharply from the vested board supremacy and discretion of boards of Delaware issuers. It raises the question on how this can be explained, particularly since the EU introduced a comprehensive and in fact 'federal' US-style securities law. Thus the EU embraced the basic regulatory disclosure architecture of regulating the relationship between issuers and the financial market(s) in which their securities are traded/listed as the basis for market discipline. This seemingly created a commonality of starting conditions. The analysis in chapter 2, however, already revealed that the implementation of this 'federal' EU securities law into the national law of Member States did not result in complete commonality but rather shows important differences. In part these differences could be explained by already existing and preceding differences between Member States in means and systems of public and private enforcement, but we saw already that overlapping concepts of securities and corporate law, such as securities law disclosure and corporate law (institutional) 'accounting' (1st, 4th and 7th Directives) illustrating the European (EU) concept of the corporation as institution protecting members (shareholders) and third parties, creditors and employees (e.g German AG), also resulted in remarkable differences.

A further strengthening of the EU securities disclosure system seems to have been hampered by the fact that the FSAP agenda at the time was not yet fully executed and implemented, the lack of a proper integration of the 2003 Action Plan into the FSA agenda and national responses (codes) that did not build on full implementation of the completely revised securities regulation of the then unfinished FSAP agenda, and the more structural element that EU securities regulation does not provide for 'federal' rules on private enforcement[308] by investors, such as a common action for 'securities fraud', since this is left to the Member States. Hence, the starting conditions at the outbreak of Enronitis were different in the US and the EU. The remaining connection and overlap between substantive and formal securities and corporate law unveils the basic 'vulnerability' to path dependency.[309]

The EU FSAP was not a regulatory response to the bursting of the dotcom bubble and the corporate scandals accompanging these events, nor was it the final result of directives and regulations that together constitute 'EU securities law'. (Only now is the EU consulting on amendments following the financial crisis and the wave of shareholders' activism.)[310] Its aim was rather to complete a common European financial market by providing a 'federal' regulatory system of securities law. Evidently such a system will not create commonality of factual markets with dispersed or concentrated holdings by itself.

Meanwhile market structures, market for corporate control and shareholder activism changed considerably and put pressure on the division of powers between board, GMS and (groups of) shareholders and on the classical organisational pattern of the public corporation. This will be further elaborated on in this chapter: regulatory responses to corporate scandals, the influence on board supremacy and different exposure to shareholder activism. The EU was not neutral in this debate. The European Commission aimed at common rules (in the 13th Directive) for the market for corporate control and assigned the High Level Group to come up with proposals for creating a level playing field. As shown, inter alia, by

308 Cf. amongst others Guido A. Ferrarini and Paolo Giudici, Financial Scandals and The Role of Private Enforcement: The Parmalat Case, ECGI-Law Working Paper, No. 40/2005.

309 Mark J. Roe, Political Determinants of Corporate Governance: Political Context, Corporate Impact, Harvard Law John M. Olin Center for Law, Economics, and Business, Discussion Paper No. 451, 2003

310 EC's Report on the operation of Directive 2004/109/EC on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market, SEC (2010) 611; see also Consultation on Modernisation of the Directive 2004/109/EC (transparency requirements for listed companies) of May 2010.

its proposal for a 'break-through' rule, this debate between the EU and Member States necessarily was directly related to the internal affairs of issuers and the ultimate power of investors, including the very notion of board supremacy and discretion to protect the interest of the company in the pursuit of the issuers' strategy, policies and affairs. The final Transparency Directive provides securities law rules to be applied in the market process of a takeover bid and only optional rules on board neutrality during such process.
Member States *did* give such national 'post-Enron' regulatory responses. So did the EU in its 2003 response to the HLG report. These, as stated before, rather turned to *corporate* law answers. Thus the EU/MS regulatory responses seem to build on the classical EU pattern to regulate issuers and their governance by corporate law means to protect shareholders (and third parties) rather than by market oriented federal disclosure rules, as in the US. The EU has no Model Act (like the US MBCA) that, although non-binding, provides a common conceptual framework.
All this, however, still does not provide us with a complete explanation of the question before us. In this chapter these differences will be analysed against (then) existing governance systems of corporate and securities regulation and the ends and means by which issuers are run. The focus will be on investor protection in *corporate* law: shareholders rights and board supremacy in the 'internal affairs' of issuers.

3.1.3 Different corporate governance codes and the lack of common EU approach

As stated before, the May 2003 Action Plan seems to mark a shift towards a corporate law approach. In hindsight the EC thus added to the confusion, by also involving itself in the corporate governance debate and its policy to strengthen the powers of shareholders. Unlike in the US, a wave of new and amended national 'self-regulatory' corporate governance codes emerged in the EU partly responding to 'Enronitis', sometimes to prevent strict rules of mandatory law; as in the UK, the Netherlands and Germany they build on the ongoing governance debate and pressure for responding to market pressure. They are applicable to issuers within their jurisdiction (and usually not dependent on their securities being traded in a certain market). Principles and best practices usually have a mixed character since both securities law (disclosure) and corporate law items are covered. The latter intrude into the internal affairs of issuers by rules on the role and organisation of boards, the role of executive and non-executive directors, board committees and membership, conflicts of interest, the role of the GMS, the auditor, the division of corporate power between these bodies corporate, but also on the relationship ('dialogue') with investors. On the other hand, they cover issues directly linked to drafting and preparing the accounts: role of audit committees, audit report, internal controls, in control statements, risk factors, strategy discussion, etc. These differences largely reflect the different mix of corporate and securities law protection in the Member States. They did not build on the FSAP process (at that time still under way), not on its basic concepts and patterns. They are in principle non-binding, but subject – by the amendment 4th Directive, art. 46a[311] EU law – to the rule of 'comply or

311 See 4th Directive as amended by Council Directive 2006/99/EC of November 2006, OJ L 363/137, art. 46a, 20.12.2006. A company whose securities are admitted to a regulated market within the meaning of the Financial Market Directive shall include a corporate governance statement in its annual report.

explain'. Consequently enforcement in a strict sense is in principle not possible. *In principle*, because different means to press for observance may be available. In the UK, the Code is part of the LSE Listing Rules. In the Netherlands, 'observance' of the Code is a matter for the AGM but upon judicial review in an investigation procedure before the Chamber of Business of the Amsterdam Court of Appeal (and supported by the Supreme Court) its content has been upheld as 'custumory' law (generally accepted principles), at least where the issuer disclosed that it had 'committed' itself to observance of the Code (for further elaboration, see chapter 4). Therefore they may underscore private actions of investors.[312]
Thus the (EU's and MS's) regulatory responses are fragmented over corporate and securities law rules by different regulatory instruments, amending prevailing EU *corporate law* directives and issuing new recommendations and – at the national level of Member States – by amending corporate law (for example, in the Netherlands strengthening of shareholder rights), but also through new or amending of existing 'self-regulatory' corporate governance codes on the boundary of corporate and securities law differing also in nature and status. These rules show 'path-dependant' differences of their national systems of checks and balances between investors and the firm traditionally largely governed in *corporate* rather than in their only slowly (and at a different speed) emerging *securities* law.
Again in contrast: US Congress stayed with the basic structure of the SA'33 and SEA '34 and enhancement thereof by SOx. SOx focuses on enhancement of (the quality of) financial disclosure to the market and strengthening of sanctions[313] to maintain integrity in the securities markets and fairness to investors.[314] To repeat, SOx did not essentially change corporate law. The principle of board supremacy in the US remained the primary standard, upheld by the US judiciary in disputes relating to the internal organisation ('internal affairs') of US issuers, also allowing the board to defend the target in a control transaction. The principle survived recent developments and shareholder activism.
It shows that markets matter, as does law. That picture is thus different for the (member countries of) the EU.

312 Cf. Eddy Wymeersch, Enforcement of Corporate Governance Code, *ECGI-Law Working Paper* 46, 2005; cf. also Erik Berglöf and Stijn Claemens, Corporate Governance and Enforcement, *World Bank Policy Research Working Paper*, 3409, Sept. 2004; cf. also oratio Alain Pietrancosta, 'Enforcement of Corporate Governance Code', as Anton Philips Professor 2008-2009, Tilburg University.

313 Raaijmakers, *Ondernemingsrecht, Pitlo/Raaijmakers,* Deventer: Kluwer 2006, p. 320.

314 ABA study on listing standards and corporate governance, p. 64, A US study on listing standards and corporate governance states in 2002 that: "corporate governance codes of different kinds have proliferated throughout the world. Many of them are comprehensive. However, the best practises guidelines contemplated by their proposal should be limited to the corporate governance areas that are necessary for and directly relevant to maintenance of integrity in the securities markets and fairness to investors. In light of recent widely published corporate failures, the issue of defining the most effective approach to improving corporate governance as it affects markets is squarely presented at this time. It is not necessary or even desirable to redesign the current system to achieve ongoing improvement in the process. Improvement should be built on the strengths of the existing system. Any significant change in the system creates the potential of new risks to the capital markets, issuers and investors, and should only be established after careful and focused study. Any systemic change should take into account the role of state corporate law in governance, corporate governance codes and practices and the appropriate areas of concern to and interest of the exchanges."

3.1.4 Reasons for further comparative analysis

These introductory observations indicate that US and EU regulatory choices and responses to market and other developments over the last decades resulted in remarkable differences. Globalisation of financial markets and economies seemed not to accompany a convergence of 'standalone' market regulation and investor protection by and enforcement of securities law, nor with a common governance model. When a corporation goes public to finance itself by issuing shares, it does so 'as is', for example with its prevailing governance under its jurisdiction[315] and with its articles of association or bylaws determining its internal affairs, fiduciary duties and assignment of the board, judicial review (also business judgement) and dissemination of powers between board, AGM and the rights of individual (or groups of) investors and causes of action (including derivative suits and class actions). Securities regulation and listing requirements will apply and determine its relation with the market and its former and new investors. Further comparative analysis may be helpful for various purposes.

First, it may contribute to a better understanding of the broad regulatory process as such in the field of protecting both investors in financial markets and firms that 'go public' by issuing shares in those markets. More particularly: a proper demarcation (or as the case may be: overlap) between the ends and means of both securities and corporate law to allow more precise regulatory impact assessment (including 'self-regulation' by corporate governance codes and delegated regulation). Evidently (public/private) enforcement is a key element (this will be the topic of chapter 4).

Secondly, it thus may improve conceptualisation of the basics of securities law and its public and private enforcement and to elaborate (common) principles of market integrity and the issuer's integrity to the market.

Thirdly, it may allow a better understanding of initial regulation and subsequent assessment of the impact thereof on the corporate statute of issuers upon going and being 'public'.

Fourthly, it may facilitate investors assessing differences and commonalities of markets and issuers in those markets, more specifically their 'shareholders powers'.

Fifthly, it may allow issuers a better (comparative) assessment of the impact of securities and corporate law (including codes) upon going and being public on the dissemination of powers between investors and the board and (the degree of) 'board supremacy'[316] in its internal organisation, corporate causes of actions for investors to enforce their rights (as will be elaborated in chapter 4) and, hence, the exposure to shareholder activism and the market for corporate control. Such assessment may allow a well considered choice of both the issuer's seat and the market in which securities will be issued. Evidently the result of that analysis may reveal that securities regulation may no longer show great differences

315 See, for example ASMI, which got a listing at Euronext Amsterdam, and went public with an oligarch governance structure, however stated and clearly disclosed in the prospectus. Recently this Netherlands founded corporation received much criticism from (activist) shareholders concerning its strategy and governance structure.

316 This principle was firmly vested in German (1937 Führer-prinzip) and Netherlands (Forum-bank), law, for example.

but that different regimes for the issuer's internal affairs may influence, inter alia, their choice of jurisdiction.[317]

3.1.5 Roadmap for this chapter

This chapter will analyse the division of powers between board (BoM/SB) and shareholders' meeting and compare major elements of the corporate (securities) law systems in the US and the EU and some Member States (UK, the Netherlands and Germany).

First, some theoretical concepts of the corporation and its governance (agency theory) will be briefly explored as well as changing market structures and the market for corporate control to better understand the commonalities and differences between the US and EU and some MS systems of investor and shareholder protection, the different regulatory responses to Enronitis and recent developments and the exposure to shareholder activism. Several elements require closer attention. Thereafter, a comparison will be made of the statutory division of powers in listed public corporations in the several systems. GMS rights are of course important, for example its required approval for an important change of identity or character of the corporation entailing a low threshold, as in the Netherlands of one third subsequently influences the supremacy of the board (BoM/SB). Alongside the collective powers of shareholders 'in meeting', the GMS as a body corporate of the issuer, shareholders also have statutory individual and groups rights and powers. Individual rights clearly encompass voting rights, the right to receive dividends and distributions from a pay out by the issuer and the residual rights upon dissolution. As part of these individual rights of shareholders' the possibilitys to make them concrete by using the mechanism of voting, for example the possibility to call an extraordinary meeting, to put items on the agenda of the meeting, proxy solicitation and voting influence the division of power between the board and the shareholders. [318]

In particular, if focussed on the supremacy of the board, the Dutch system, in comparison to the other examined systems, the substantial rights of the GMS and the procedural shareholder's rights to effectuate these rights seemingly led to a stronger position in the organisational design of the issuer (in combination with the unique Dutch right of inquiry, as has been elaborated in chapter 4, this seemingly resulted in an erosion of the Dutch board). This seems however to be concealed by the international header of corporate governance and resulting principles and 'best practices' to discipline management and protect investors. These also conceal the lack of clear US-style distinction between the regulatory ends and means of securities regulation and corporate law respectively. It seems to bypass the traditional regulatory role of corporate law in (Member States of) the EU to protect investors (shareholders) *by means of corporate law* (often based on 'institutional' and the so-called 'stakeholder' model). Thus Chapter 3 (pars. 3.3–3.6) explores in more detail the (statutory) division of (collective and individual) powers of investors (GMS) and the board/SB and, hence, both the nature of protection thus provided to investors (as shareholders) and

317 See Luca Enriques & Tobias H. Troeger, 'Issuer choice in Europe', *ECGI-Law Working Paper No. 90/2007,* July 2008, Roberta Romano, 'The Sarbanes Oxley Act and the making of Quack Corporate Governance', *NYU, Law and Econ Research Paper 04-032*, 25 September 2004.

318 Extension shareholder rights. See EU Directive in shareholder rights concerning: record date, proxy voting, electronic voting, no solution for ultimate holder problems.

the statutory level and extent of board supremacy, taking into account recent developments that affected the prevailing systems. Although there is more than one good reason to extend the research to other areas as well, this will be limited to these two markets. Par. 3.7 will draw some preliminary conclusions.

3.2 Basic concepts of 'public corporations' and their regulation

This paragraph summarises concepts underlying today's theory of the firm, corporate form and corporate governance (agency theory) since these theories, specifically those developed in the school of law and economics (L&E), seem to have largely influenced the public debate of the last decades on (regulation of) market structures, firms, governance, control transactions, investor protection, codes of best practices, public oversight and enforcement mechanisms.

This debate also directly influenced legal theory and concepts and, hence, regulation and guided regulatory action in the field of corporate and securities regulation, also in response to "Enronitis". It is important to note that the L&E analysis and concepts over time and certainly in the EU and several of its Member States have influenced the way in which markets and its participants are analysed as well as classical corporate law concepts, for example the concept of investors being 'owners of the corporation' in contrast to the view that they only 'own' shares in the issuer. It may explain why and how the EU and several of its Member States besides their own institutional approach of protecting members and third parties (e.g. 1937/1965 German AktG), have reacted so differently post-FSA to corporate scandals when it was developing a new overall securities law (FSAP) and, therefore, was not properly prepared to fine-tune its responses as US Congress did by enhancing the system of financial reporting to the market (SOx). Concepts and language seem to have been used somewhat out of context.

3.2.1 The 'Agency Theory' and the corporate governance debate

The public corporation[319] with publicly traded shares is the business form that issuers mostly often use to go public.[320] Berle & Means concluded to the separation of ownership from control in such firms.[321] That separation and, hence, board supremacy were enacted as

319 One of the features of the public corporation is that shares are fully tradable. This feature maximises the liquidity of shareholdings and the ability of shareholders to diversify their investments. It also gives the firm maximal flexibility in raising capital.

320 Another thing is that also publicly held corporations vary a lot. Some firms go public under rules that stifle any attempt at control: Ford, for example, issued non-voting stock, leaving the firm in family hands for a long time. Some managerial teams attempt to insulate themselves from investors' control in order to carry out programmes that they view as more important than profits. Both the *New York Times* and the *Wall Street Journal* have established structures that give their managers substantial freedom to produce news at the potential expense of profit. The way in which corporations run the business, control agency costs, raise money and reward investors will change from business to business and from time to time within a firm, see Frank H. Easterbrook and Daniel R. Fischel, *The economic structure of corporate law*, Cambridge: Harvard University Press, 1991, p. 13.

321 A. Berle and G. Means, *The Modern Corporation and Private Property*, New York : Harcourt, Brace and World 1967. The first edition was published in 1932.

corporate law principle for 'public' corporations (AGs) in the German AktG as early as 1937: "Der Vorstand hat unter eigener Verantwortung die Gesellschaft zu leiten", (§ 76 (1) AktG). In the UK, art. 2 of the Model Articles gives substantial authority to the board: "Subject to the articles, the directors are responsible for the management of the company's business, for which purpose they may exercise all the powers of the company." In the Netherlands the principle was vested by the Supreme Court in the *Doetinchemse IJzergieterij*[322] (1949) and *Forum-bank* cases[323] (1955) and codified in the present arts. 2:129 and 140 NCC; the principle had to be reconfirmed by the Supreme Court in some recent cases: ABNAMRO[324] and ASMI.[325] In Delaware General Corporate Law (DGCL), § 141(a) Delaware reads: "The business and affairs of every corporation organized under this chapter shall be managed by or under the direction of a board of directors".
In the principal agent theory, shareholders are regarded as owners of the firm (principals), whereas the managers (agents) have control. The 'property' ('control') rights are no longer held by the firm's managers (as if they were 'managing partners' in a partnership).[326] One of the principal aims of corporate (corporate governance) and securities law is the attempt to control conflicts of interest among corporate constituencies, including those between corporate insiders, such as controlling shareholders and top managers, and outsiders, such as minority shareholders or creditors.[327] These conflicts constitute – in the language of economists – agency problems or principal problems, all deriving from the following mechanism, in short: an agency relationship can be described as a contract under which one or more persons (the principals) engage another person (the agent) to perform some service on their behalf which involves delegating some decision-making authority to the agent. The problem lies in motivating the agent to act in the principal's interest rather than simply in the agent's own interest. The core problem is that because the agent commonly has more and better information than the principal about the relevant facts, the principal cannot costlessly assure himself that the agent's performance is precisely what was promised. As a consequence, the agent has an incentive to act opportunistically, skimping on the quality of his performance, or even diverting to himself some of what was promised to the principal. This means, in turn, that the value of the agent's performance to the principal will be reduced, either directly or because, to assure the quality of the agent's performance, the principal must engage in costly monitoring of the agent. Besides monitoring costs, bonding and residual costs can be distinct. In some situations, the agent will expend resources (bonding costs) to guarantee that he will not take certain actions which would harm the principal or to ensure that the principal will be compensated if he does take such action. Under this theory there will always be some divergence between the agent's decisions and

322 Dutch Supreme Court 01-04-1949, *NJ* 1949, 465.
323 Dutch Supreme Court 21-01-55, NJ 1959,43, AA 2006, 522, *Forumbank Revisited,* prof. mr. M.J.G.C. Raaijmakers
324 Dutch Supreme Court 13 juli 2007, R07/100HR (Enterprise Chamber 135) (with annotation of M.J. van Ginneken)
325 Dutch Supreme Court 9 juli 2010, *LJN* BM 0976, Enterprise Chamber.
326 A. Berle and G. Means, *The Modern Corporation and Private Property*, New York: Harcourt, Brace and World 1967. The first edition was published in 1932.
327 Cf.L. Bebchuk, Alma Cohen and Allen Ferrell, 'What Matters in Corporate Governance', *Harvard, John M. Olin Center for Law, Economics, and Business, Discussion Paper No. 491, 09, 2004.*

those decisions which would maximize the welfare of the principal.[328] Minds differ however as to whether corporations/issuers themselves are able to reduce agency costs by being responsive to market and shareholders' demands or whether external change of corporate governance systems is needed.[329]

In sum, the interest of shareholders may be damaged by the 'moral hazard' that the board and officers are exposed to and therefore various disciplinary mechanisms are elaborated: 1) alignment, which departs from the assumption that interests of executives should be aligned with those of shareholders by linking executive compensation more closely to company performance; stock-based pay should provide a direct link between pay and performance and should play a role in mitigating 'agency-problems' between managers and shareholders[330]; 2) bonding, which are devices to assure the fidelity of employees and agents where oversight is impractical or too costly, [331] for example if an agent agrees to place a portion of his or her salary in escrow to assure faithful performance;[332] and 3) monitoring, by instalment of independent directors[333] and gatekeepers, for example auditors,[334] but also through the market for corporate control. The market for corporate control in that sense is an important accountability mechanism (such as director liability cause of breach of fiduciary duties). A corporation's poor performance in its product market is reflected in the market price of its stock. Where poor performance is due to management inefficiency, the potential for gain exists through purchasing the corporation's shares at the depressed price and then installing efficient management. Two important conditions are necessary for this concurrence of results. First, the market price of the corporation's stock must accu-

328 C. Jensen and William H. Meckling, 'Theory of the Firm: Managerial Behaviour, Agency Costs, and Ownership Structure', in: Roberta Romano, *Foundations of Corporate Law*, Foundation Press 1993, p. 7. See Prof. H. Schenk, 'Hefbomen van het moderne financieringskapitalisme', *Ondernemingsrecht* 2007, No. 5, p. 180-185 for critical remarks on the normative value of this theory.

329 Cf. Bill W. Bratton and Michael L. Wachter, the Case against Shareholder Empowerment, *University of Pennsylvania Law Review* 2010, vol. 158: 653, these mechanisms also play a role in the responsiveness of issuer's corporate governance systems to demands of activist shareholders.

330 Martin J. Conyon and Kevin J. Murphy, 'Stock-Based Executive Compensation', in: Joseph A. McCahery, Piet Moerland, Theo Raaijmakers and Luc Renneboog (eds.), *Corporate Governance Regimes, Convergence and Diversity*, New York: Oxford University Press 2002, p. 625–646. Piet Duffhues, Rezaul Kabir, Gerard Mertens, and Peter Roosenboom, 'Emloyee Stock Option Grants and Firm Performance in the Netherlands', in: Joseph A. McCahery, Piet Moerland, Theo Raaijmakers and Luc Renneboog (eds.), *Corporate Governance Regimes, Convergence and Diversity*, New York: Oxford University Press 2002, p. 668-678, finding a positive relationship between stock option grants and firm's operating performance. Firms with high returns grant relatively more employee stock options. Furthermore, stock option schemes lead to higher operating performance in the subsequent year. Cf. Raaijmakers, *Ondernemingsrecht, Pitlo/Raaijmakers,* Deventer: Kluwer 2006, p. 318.

331 Robert W. Hamilton, *The Law of Corporations in a nutshell,* West Group 2000, p. 56.

332 William A. Klein and John C. Coffee Jr., *Business Organizations and Finance, Legal and Economic Principles*, New York: Foundation Press 2004, p. 177.

333 Cf. James D. Cox, 'The Oligopolistic Gatekeeper: The US Accounting Profession', in: John Armour and Joseph McCahery (eds.), *After Enron, Improving Corporate Law and Modernising Securities Regulation in Europe and the US*, Oxford: Hart Publications 2006.

334 Raaijmakers, *Ondernemingsrecht, Pitlo/Raaijmakers,* Deventer: Kluwer 2006, p. 318 and cf. James D. Cox, 'The Oligopolistic Gatekeeper: The US Accounting Profession', in: John Armour and Joseph McCahery (Eds.), *After Enron, Improving Corporate Law and Modernising Securities Regulation in Europe and the US*, Oxford: Hart Publications 2006, p. 295-342. See SA'33, 15 U.S.C.§ 77aa (25) (26); § 13 (a) (2) SEA, 15 U.S.C. § 78m (a) (2), made this formerly voluntary practice a requirement for public companies.

rately reflect the incumbent management's inefficiency. Disclosure of financial information to the markets plays an important role and underpins the monitoring function of that market and the working of the market for corporate control. However, stock prices are not always efficient, as we have seen in the Enron bankruptcy and more recent volatile stock prices at the start of the financial crisis; the school of behavioural economics uses cognitive and social psychology for market behavior.[335, 336] Secondly, there must be mechanisms available for displacing incumbent management.[337]

The global debate was largely influenced by these concepts. Corporate governance, as Shleifer and Vishny describe, deals with the way in which suppliers of finance to corporations assure themselves of getting a return on their investment[338], or as the Higgs Report defines very generally but differently as the system by which companies are directed and controlled.[339] The 'agency theory' seems to have inspired and guided new corporate regulation as illustrated by topics such as bonding and alignment of directors, also seemingly in relation to regulatory responses to corporate scandals. See for example the Dutch Code Tabaksblat 2003 (renewed by the Frijns Commission in 2008 and put into operation as of 1 January 2009 as the Dutch Corporate Governance Code (DCGC)), which aimed to restore the confidence of investors in capital markets/stock markets and governance of listed public corporations, not only by strengthening financial disclosure to the market but also by amplifying the rights of shareholders as 'members' of the corporation and in so doing also clarifying relations between board and GMS.[340] Thereby the DCGC (2003) aimed at changing

335 Cf amongst others Donald C. Langevoort, 'Taming the Animal Spirits of the Stock Markets: A Behavioural Approach to Securities Regulation', in: John Armour and Joseph McCahery (eds.), *After Enron, Improving Corporate Law and Modernising Securities Regulation in Europe and the US*, Oxford: Hart Publications 2006, p. 65-126 and Bill W. Bratton and Michael L. Wachter, 'The Case against Shareholder Empowerment', *University of Pennsylvania Law Review*, vol. 158: 653, 2010. See also A. Shleifer, *Inefficient Markets: An Introduction to Behavioural Finance,* Oxford: Clarendon Press 2000.

336 Cf M.J.van Ginneken, 'De Passiviteitsgedachte in het Amerikaanse recht', in: M.P. Nieuwe Weme, G. van Solinge, R.P. ten Have and L.J. Hijmans van den Bergh (eds.), *Handboek Openbaar Bod, Serie Onderneming en Recht*, deel 46, Deventer: Kluwer 2008, p. 1067-1094, makes an interesting remark on the contradiction between the 'neutrality rule', in essence resulting from the belief in an efficient market for corporate control and plurality of interests are in conflict with each other. The neutrality would lead to a board focussing on the share price on the short term, just to prevent to become a target in the market.

337 Ronald J. Gilson and Bernard S. Black, *The law and Finance of Corporate Acquisitions*, Westbury, New York: The Foundation Press, Inc. 1995, p. 363, Henry Manne, 'Mergers and the Market for Corporate Control', *The Journal of Political Economy,*Vol. 73, No. 2, 1965, p. 110-120, which is the seminal work on the market for corporate control as a means of corporate accountability; See William J. Carney, 'The legacy of "The market for Corporate Control" and the Origins of the Theory of the Firm.', *50 Case Western Reserve Law Review*, 215, 1999; Fred S. McChesney, Henry G. Manne, 'Mergers and the Market for Corporate control', *50 Case Western Reserve Law Review* 245, 1999.

338 A. Shleifer and R. Vishny, 'A survey of Corporate Governance', *52 Journal of Finance* 737, 1997, P.W. Moerland, *Corporate Governance, Theorie en praktijk in internationaal perspectief,* Wolters-Noordhoff 1997. The UK Combined Code on Corporate Governance, Preamble 1: "Good corporate governance should contribute to better company performance by helping a board discharge its duties in the best interests of shareholders; if it is ignored, the consequence may well be vulnerability or poor performance. Good governance should facilitate efficient, effective and entrepreneurial management that can deliver shareholder value over the longer term."

339 The Higgs Report: review of the role and effectiveness of non-executive directors.

340 See the DCGC, 'Verantwoording van het werk van de Commissie, p. 3 and p. 37. See also Raaijmakers 2006, p. 323.

the division of powers as well as the supremacy of the board in a listed NV and to strengthen the position of investors,[341] remarkably its principles/best practices sometimes even go further than statutory law. See for example the former Principle IV.2 on 'Depositary receipts for shares', stating that 'Depositary receipts for shares shall not be used as an anti-takeover measure. The management of the trust office shall issue proxies in all circumstances and without limitation to the holders of depositary receipts who so request. The holders of depository receipts thus authorised can exercise the voting right at their discretion.'

3.2.1.1 Convergence of Corporate Governance

Some scholars have observed that corporate governance systems throughout the world are converging (with the shareholder model dominant),[342] others that path dependency still constrains such convergence. However, in spite of globalisation of economies and financial markets, corporate governance systems and ownership structures are still very different[343] showing that an economy's structures, including the composition of the system of securities and corporate law at any point in time are likely to depend on those that it had in earlier times.[344, 345] Evidently, so far the comparative debate focussed primarily on the 'transatlantic'

341 Raaijmakers 2006, p. 324.

342 Hansmann/Kraakman, *End of history for corporate law,* Yale Law School Working Paper no. 235; NYU Working Paper No.013; Harvard Law School Discussion Paper No. 280; Yale SOM Working Paper No. ICF-00-09.

343 Companies with dispersed ownership and companies with concentrated ownership co-exist in, all major jurisdictions. Nonetheless the corporate universe divides in to two basically alternative systems of corporate governance:1) A dispersed ownership system, characterised by strong securities markets, rigorous disclosure standards, high share turnover, and high market transparency, in which the market for corporate control constitutes the ultimate disciplinary mechanism; and 2) a concentrated ownership system, characterised by controlling block holders, weaker securities markets, high private benefits of control and lower disclosure and market transparency standards, but with a possibly role played by large banks and non-controlling block holders, John C. Coffee, jr, 'A theory of corporate scandals: why the US and Europe differ', *Columbia Law School and Economics Working Paper No. 274,* March 2005. In comparative corporate governance one of the themes is explaining why ownership structures are in Europe, with the UK as common law country with dispersed ownership, much more concentrated then in the US. Shleifer & Vhisny in their famous article Law and Finance explain this difference by the distinction between the civil and common law tradition with the latter providing a better protection for shareholders. And that again induces a more dispersed ownership of shareholders.

344 Path dependence can be structure driven or rule driven. The former concerns the direct effect of initial ownership structures on subsequent ownership structures. This theory shows how the corporate structures that an economy has at a given point in time are influenced by the corporate structures it had earlier. There are two reasons for such structural path dependence, one grounded in efficiency and the other grounded in rent-seeking. The other type of path dependence is rule driven, initial ownership structures affect subsequent structures also through affecting the corporate rules under which these subsequent structures will be chosen. There are two reasons, one grounded in efficiency and the other in interest group politics (political theory), explaining why a country's legal rules at any point in time might be influenced by the ownership patterns that the country had at earlier times, Lucian A. Bebchuk and Mark J. Roe, 'A theory of Path Dependence in Corporate Governance and Ownership', *Columbia Law School, The Center for Law and Economics Studies, Working Paper no. 131*, November 1999.

345 See Lucian A. Bebchuk and Assaf Hamdani, 'The Elusive Quest for Global Governance Standards', *University of Pennsylvania Law Review*, Vol. 157, 2009, pp. 1263-1317, for an interesting article that touches upon the convergence debate; they criticise metrics assessing governance of public companies around the world often not paying attention to differences in ownership structures. They argue that the quest for global governance standards should be replaced by an effort to develop and implement

jurisdictions with less attention the 'BRIC' countries (Brazil, Russia, India & China). This study also restricts itself to that area. It is, however, clear that subsequent research should start to include markets that are gradually shifting from 'emerging' status to 'major' markets.

As perceived by going public, a corporation is exposed to the discipline of the market and influence of investors, however the IPO not being a control transaction per se, the autonomy of the corporation and its board (SB) is not already eroded. However, when a corporation is the subject of takeover rumours in the market, market pressure and also the treat of liability for board members have a strong influence, particularly when the corporation is at play. However global and interwoven the financial markets are, the market and corporation in which they invest still preserve their particular territorial and jurisdictional character.

3.2.2 'Governance' and its relationship with financial markets and the market for corporate control

In continental Europe, most markets are not characterised by dispersed shareholders, but the UK market with its dispersed shareholders and very liquid markets is regarded as an exception. The Dutch market can be defined as 'mixed' system[346] and the German market has still a block holding regime.[347] Evidently the principal/agency problem works out differently in different market structures. For example, abuse of a minority shareholder by a major shareholder and/or management may evidently occur more easily in corporations with a major shareholder.

The takeover market has its own dynamics, but is not uniform. It was the emergence of the market for corporate control that pushed the issue of (limiting) board supremacy to the core of the debate or even brought about the emergence of the 'CG' debate. With dramatically changing world economies and financial markets the market for corporate control really emerged from a theoretical concept to reality in corporate life. It is part of the L&E as well as the more traditional legal corporate governance debate. Disciplining/monitoring directors is one of the pillars, including: oversight on directors, disclosure (also related party transaction, director loans etc.), alignment of board and shareholder interest and market for corporate control.[348] The crucial question remains: is the board of a target company allowed and legitimated to resist a hostile takeover even if a majority of investors would be prepared to accept the offer of the bidder? Evidently, this question has to be placed against the background of market structures and financing patterns of specific issuers (block-

separate methodologies for assessing governance in companies with and without a controlling shareholder. They also identify the key features that these separate methodologies should include, and discuss how to apply such methodologies in either country-level or firm-level comparisons. Cf. also the takeover fight for ABNAMRO.

346 Moerland, *Corporate Governance, Theorie en praktijk in internationaal perspectief,* Wolters-Noordhoff 1997.

347 Van der Elst, Christoph, Abe de Jong and Theo Raaijmakers, 'Een overzicht van juridische en economische dimensies van de kwetsbaarheid van Nederlandse beursvennootschappen', *Report to the Social and Economic Council of the Netherlands (SER),* 2007. Cf. also Christophe van der Elst, Shareholder Mobility in Five Euroepan Countries, *ECGI-Law Working Paper* 104, 2008.

348 M.J.G.C. Raaijmakers m.m.v. P.A. van der Schee, 'Regulering en handhaving van overnamebiedingen in perspectief', in: M.P. Nieuwe Weme, G. van Sollinge, R.P. ten Have en L.J. Hijmans van den Bergh (eds.), *Handboek Openbaar Bod, Serie Onderneming en Recht*, deel 46, Deventer: Kluwer 2008, p. 3.

holders, size of free float). The US and EU differ both in market liquidity and degree of dispersion of ownership of shares. Consequently their takeover rules differ. The US Williams Act in 1968 already focussed on federal *securities* regulation of the bidding process, leaving the corporate law elements to local state law. Despite the influence of the 'agency theory' the answer under Delaware corporate law is quite clear: apart from exceptions (Revlon) the board may indeed resist a hostile takeover; it will be protected by the business judgement rule if attacked in a derivative suit initiated by shareholders.[349]

The situation within the EU is less clear and ranges from board neutrality in the UK (General Principle 3 and Rule 21 UK City Code), to a Delaware-like position (similar function of US anti-takeover statutes and German concept of 'interest of the firm' WpÜG § 3 (3) in Germany, to unclear border lines in the Netherlands (that were clarified only very recently; see chapter 4). A level playing field in this respect does not really exist in the EU, despite the outspoken policy of the European Commission to achieve such common ground. Its attempt to force such result by mandatory *corporate law* rules in the draft 13th Directive, supported by the advice of the HLG, failed. The final Transparency Directive had a mixed character, again reflecting the overlap between securities and corporate law. Like the US Williams Act it contains market rules (securities law) for takeover bids under public oversight, i.e. 'traffic' rules regulating a public takeover bid by means of rules on proper market disclosure to allow assessment of the bid by the market and investors. The aim to also achieve a common market for corporate control by a 'level playing field' failed: only *optional* corporate law rules were adopted regarding the 'internal' relationship between the board and the investors and the meeting of shareholders respectively (i.e. breakthrough and board neutrality) (arts. 9-12). The structure of financial markets and shareholdings are of course not per se changed by the Takeover Directive and differences remain: dispersion versus concentration with institutional investors and pension funds, pyramid constructions, family holdings, state influence and forms of employee participation.[350] Such a level playing field was therefore not reached in the EU and still less on a global scale with the US and the BRIC countries. Protectionist reactions seems to endanger the global economy in the post-credit crunch era.

Ergo: the corporate and securities regulation and enforcement of these rules (self-regulation, public oversight and judicial intervention) still differ between jurisdictions and therefore changes in markets and regulation may and also presumably will have different consequences.

349 Cf M.J.van Ginneken, 'De Passiviteitsgedachte in het Amerikaanse recht', in: M.P. Nieuwe Weme, G. van Solinge, R.P. ten Have and L.J. Hijmans van den Bergh (eds.), *Handboek Openbaar Bod, Serie Onderneming en Recht*, deel 46, Deventer: Kluwer 2008, p. 1067-1094. See also his dissertation M.J. van Ginneken, Vijandige overnames, De rol van de vennootschapsleiding in Nederland en de Verenigde Staten, Kluwer: 2010.

350 Zie Henry Hansmann en Reinier Kraakman, 'Towards a Single Model of Corporate law?' In: Joseph A. McCahery et al. (eds.), *Corporate Governance Regimes,Convergence and Diversity,* New York: Oxford University Press 2003, p. 56-82. Their article seems to be inspired by the famous book by Francis Fukuyama, *The End of History and the last man* (1992). His prophecy related to the development of a universal model of a liberal democracy on capitalist foundation, needs to be refined in the light of later developments in inter alia Russia, China and India.

3.2.3 Ends of the public corporation (issuers)

Corporate governance has consistently been debated against the background of the ultimate aims of the (public) corporation/issuer. [351] The overall objective of corporate law is to allow entrepreneurship as well as to serve and protect the interests of society as a whole. More particularly, the ultimate goal of corporate law is to advance the aggregate welfare of a firm's shareholders, employees, suppliers and customers. Economists would characterise this as the pursuit of overall social efficiency.[352] This is no different from other business forms, such as partnerships and sole proprietors.

The common view in the US is that the corporation focuses (and should focus) primarily on maximisation of shareholder return. It is taken to be the best *end* by which corporate law can serve the broader goal of advancing overall social welfare.[353] It will also reduce the cost of collective decisions, because shareholders' interests are more homogenous than for other groups. However, this claim can be put into perspective by also considering the very different constellation of shareholder/investor base of the listed public corporation, where day traders, hedge funds, state wealth funds, private equity, institutional investors and mutual funds can be distinguished, all having their own interest and investment horizon.[354]

US corporate law presumes that firms should be managed for shareholders' and not managers' interests when those interests conflict. However the shareholder-wealth maximisation norm seems not be an appropriate means for judicial enforcement except in especially provocative situations, as in the famous case of *Revlon*, in which the court held that only under certain conditions does the board have to aim for the highest value for the share-

351 In the market-oriented systems the external labour market and remuneration systems play an important role, for network-oriented systems the internal mobility of managers is more characteristic. PvS: related to remuneration our system seemingly has moved to the US model

352 See Kanning and Kerkmeester, *Economie en recht*, Groningen/Houten: Wolters-Noordhoff: 2004, p. 28.

353 See also R. la Porta, F.L. de Silanes, a. Shleifer and R.W. Vishny, Investor Protection and Corporate Governance, June 1999. There are a number of persuasive explanations for the perspective of maximising shareholder revenues. First, in competitive markets, maximizing share value allocates resources efficiently and thereby maximises social welfare. Second, in competitive markets, it provides managers with a clear-cut decision rule that maximizes the utility of the firm's owners who may have disparate preferences for current and future consumption, because it enables shareholders to trade against the increased value to achieve whatever consumption pattern they wish without affecting the firm's policy. In this regard, it also reduces the cost of collective decisions, because shareholders' interests are more homogenous than other groups. This however could be contested considering the very different constellation of shareholder/investor structure (investors/shareholders: day traders, hedge funds, state funds, private equity, institutional investors, mutual funds etc.) Finally, it best matches organisational design with incentives. Because equity investments are residual claims with no fixed income guarantee or maturity date, they are the only investments in the firm that are not periodically renewed: hence, they are more vulnerable than the investments of other stakeholders, such as bondholders and employees, which can be and are protected by express contracting. See also article of Lynn Stout, '*Bad and not so bad arguments for shareholder primacy*', who contests such claims. Moerland, *Corporate Governance, Theorie en praktijk in internationaal perspectief,* Wolters-Noordhoff 1997.p. 63, who joins with the above theoretical explanation for aiming at maximising shareholder value, but emphasises that shareholders are not owners of the corporation nor that shareholders interests are or should be of a higher order.

354 Cf. G.T.M.J. Raaijmakers*, Nederlandse beursondernemingen te afhankelijk van financiele markt*, Vrije Universiteit Amsterdam: Oratie: 2009.

holders.[355] Instead, it is enforced indirectly through a complex and varied set of extrajudicial accountability mechanisms, of which shareholder voting is but one.[356]

In continental Europe and in the Netherlands, however, the stakeholder model seems to support this goal.[357] Directors and managers should consider the interests of all corporate constituencies in making corporate decisions.[358] The UK Companies Act 2006 (hereafter: § 172 UK CA 2006) introduced the concept of 'enlightened shareholder value'. The means for running the issuers' business can moreover be divided into managerial/director or shareholder primacy. Theories at the shareholders primacy end of the spectrum were traditionally founded on the notion of shareholders 'owning' the corporation. Consequently, directors and officers are then deemed to be mere stewards of the shareholders' interests.[359] Shareholders have a privileged position[360] among the corporation's constituencies, due to their 'contract' with the firm showing ownership-like features, including the right to vote and the reverse fiduciary obligations of directors and officers. Director primacy – on the other hand – has a different claim, neither shareholders nor managers, but boards of directors control corporations.[361] The continental view, on the other hand, tends to build on the concept of 'membership' of investors as shareholders in the company as an 'association'.

Fundamentally, all of these models are differing views of means and ends of the corporation as such and its corporate governance, i.e. the internal governance of issuers. These focus on two basic sets of questions: 1) As to the means of corporate governance, who decides? In

355 Judges have often affirmed the importance of maximising shareholder value. See *Dodge v. Ford Motor Co.* (1919). One of the ways of advancing that objective in the US is to impose fiduciary duties, and in particular a duty of loyalty, on corporate officers and directors: 'Managers must prefer investors' interests to their own in the event of conflict. That is the core of the duty of loyalty.

356 Stephen Bainbridge, 'Director Primacy: The Means and Ends of Corporate Governance', *UCLA, School of Law Research Paper Series, 02-06*, February 2002.

357 Cf. L. Timmerman, 'Grondslagen van geldend ondernemingsrecht', *Ondernemingsrecht* 2009, 2, he sees 'enlighted shareholder', as adhered to in the UK, as good alternative and guidline for the board instead of shareholder primacy or interest of plurality/interest of the corporation. See also H.J. de Kluiver, 'Vennootschappelijke repliek op Timmerman's grondslagen', *Ondernemingsrecht* 2009, 4, see also J.M. Blanco Fernández, 'Timmerman's gronslagen, reactie op de oratie', *Ondernemingsrecht* 2009, 5.

358 Supra note 46. See also Raaijmakers, Ondernemingsrecht 2006 and M.J.G.C. Raaijmakers, *Forumbank (1955) Revisited, Verschuivende machtsverhoudingen binnen een beurs-NV,* Ars-Aequi, 2006(7), 522-529; cf. also L. Timmerman, 'Grondslagen van geldend ondernemingsrecht', *Ondernemingsrecht* 2009.

359 Lucian Arye Bebchuk, 'The Case for Increasing Shareholder Power', *Harvard Law Review*, Vol. 118. No. 3, p. 933-914, January 2005. A more recent variant, which is one of Coase's many progeny, argues that shareholders are merely one of many factors of production bound together in a complex web of explicit and implicit contracts. Influenced by agency cost economics, proponents of this variant continue to treat directors and officers as agents of the shareholders, with fiduciary obligations to maximise shareholder wealth.

360 Bebchuk recently put forward a related set of proposals designed to allow "shareholders to initiate and vote to adopt changes in the company's basic corporate governance arrangements." As Bebchuk explains, the housekeeping rules of corporation law effectively preclude shareholders from initiating corporate action.

361 Margaret M. Blair and Lynn A. Stout, 'A Team Production Theory of Corporate Law', *Virginia Law Review, Vol. 85, No. 2*, 1999, pp. 248-328. Lynn A. Stout, 'The Mythical Benefit of Shareholder Control', *Regulation Vol. 30, no. 1*, 2007, pp. 42-44.

other words, when push comes to shove, who is ultimately in control? 2) As to the aims of the corporation and its governances, whose interests prevail?[362] Again: law matters![363]

Theory and practice may, however, differ to some extent. US shareholder primacy as the ultimate corporate objective does not apparently preclude a simultaneous recognition of board supremacy as the best economic and organisational model to create wealth, even in contested takeovers and in the face of short-term interests of investors to cash a takeover premium. [364] Similarly, the concept of serving regulatory reform, aiming at shareholder democracy is rather vague. Analysing the ideology of shareholder primacy, the ends and means of the corporation have to be distinguished. Having shareholders' interests as the ultimate goal for the listed public corporation, does not necessarily mean that they are or should be in control of the corporation. That depends on legal framework, i.e. investor protection and corporate law framework.

In this respect we should recall the analysis of chapter 2. Notably shareholder orientation also seems to underscore regulation following the FSAP and IAS and the underlying monitoring function of disclosure.

3.2.4 Evolution of regulatory responses to corporate scandals

The general nature of these theoretical foundations of the regulation of issuers will remain to influence new regulation and practice of prevailing and emerging governance systems and objectives/ends and means of the firm. Therefore this will apply to regulatory responses to corporate scandals,[365] as was the case not only in the post-Enron-era, but also upon earlier scandals in history. Since the inception of the public company, legislators in the US and EU, and in other parts of the world,[366] have reacted on or responded to such corporate scandals by various generic or specific means ranging from limiting the use of the public corporation as such to regulation more focussed specifically on issuing securities, see for example

362 Stephen Bainbridge, 'Director Primacy: The Means and Ends of Corporate Governance', *UCLA, School of Law Research Paper Series, 02-06*, February 2002. Cf. also Leo E. Strine, jr., 'Towards a true Corporate Republic: A Traditionalist Response to Lucian's Solution for Improving Corporate America', *Harvard Law and Economics Discussion Paper, No. 541,* February 2006.

363 Regulatory perspective, investor protection or corporate governance in corporate law.

364 Simon Deakin and Suzanne J. Konzelmann, 'Corporate Governance after Enron: An Age of Enlightement?', in: John Armour and Joseph McCahery (Eds.), *After Enron, Improving Corporate Law and Modernising Securities Regulation in Europe and the US*, Oxford: Hart Publications 2006, p. 155-158.

365 Corporate scandals, which happened recently on global scale and raised global questions. The corporate governance and financial reporting problems revealed by the failures at several major US firms over late 2001-2, including Enron, Worldcom, Tyco, and Adelphia (but also Ahold and Parmalat) shed new light on the convergence debate. First, the scandals emerged just at the moment when many thought that the US model was about to claim the prize as the 'best in show'. Systems that seem dominant, the US in the 1990s, Japan in the 1980s, repeatedly prove vulnerable, and this vulnerability seems to emerge before other systems converge, John Armour and Joseph McCahery (eds.), *After Enron, Improving Corporate Law and Modernising Securities Regulation in Europe and the US*, Oxford: Hart Publications 2006; Bratton, W.W. (2002), Enron and the dark side of shareholder value, 76 Tulane L. Rev. 1275; John C. Coffee, jr., Understanding Enron: It's about the gatekeepers, stupid, Columbia Law & Economics Working Paper No. 207; John C. Coffee, jr, Jeffrey N. Gordon, What Enron Means for the Management and Control of the Modern Business Corporation: Some Initial Reactions, 69 U. Chi; Gordon and Roe 2004, p. 5. See also John C. Coffee, jr, 'A theory of corporate scandals: why the US and Europe differ', *Columbia Law School and Economics Working Paper No. 274,* March 2005.

366 See also OECD corporate governance code.

the introduction of prospectus liability in the UK (1890) and the Netherlands (1928). One of the key questions remains: regulatory responses by means of securities or by corporate law? In the very early years of the Dutch United East Indian Company (VOC)[367] in 1611, the Dutch Parliament forbade short selling (securities law). The UK Bubbles Act of 1720 abandoned the use of a public company completely for more than a century (corporate law).[368] The Great Crash of 1929 fuelled the complete change of US securities regulation, resulting in the SA'33 and SEA '34 that also introduced public oversight by and regulatory power of the federal SEC leading to investor protection through disclosure (securities law). The clash between BCCI (Bank of Credit and Commerce International) and Maxwell was the prelude to the Cadbury Report and subsequent corporate governance codes.[369] The burst of the dot-com bubble and the corporate scandals of those times (Enron et al.) urged US Congress to respond by changing the prevailing securities law with the SOx.[370] The MS reacted with a series of 'self-regulatory' corporate governance codes of various natures and scopes (primarily focussing on corporate law issues, but also including disclosure items) and the EU by amending EU corporate law directives and 'soft law' recommendations. Member States also introduced a variety of amendments to corporate law[371], but remarkably also dropped the draft 5th Directive, essentially dealing with the core subjects of the internal organisation of 'large' corporations (including issuers).
The existing systems and recent amendments of corporate governance (corporate and securities law) in a global variety of jurisdictions are thus influenced by choices made by the legislators in reaction to market developments, corporate scandals and the recent financial crisis. They remain framed in the historical, political and economical background of the countries in which they function,[372] not least, as evidenced by the US, by the prior existence

367 Although the shareholders in this company had some core rights in practice they had almost no influence, H.Den Heijer, De geoctrooieerde compagnie, De VOC en de WIC als voorlopers van de naamloze vennootschap, Ars Notaratus, Kluwer, Deventer 2005, 215-216.

368 Paul Frentrop 2002, A history of corporate governance 1602-2002, Prometheus: Amsterdam 2002 and Stuart Banner, Anglo-American Securities Regulation, Cultural and Political Roots, 16909-1860, Cambridge University Press 1998, 75-86 for a more detailed version of the financial crises in England of 1720 and the following reaction from the legislator.

369 Hopt 2006, p. 1182, the beginning can be pinpointed precisely to 1992 when the Report of the Committee on the Financial Aspects of Corporate Governance was published in London, this has become known internationally as the Cadbury Report after the name of the chairman of the committee. It was the first in whole series (Greenburry, Hampel, Higgs, and Tyson) and is now consolidated in the Combined Code which is issued as an appendix to the Listing Rules, and dates in its revised form from 2003.

370 Sarbanes-Oxley Act, 30 July 2002, Pub L No 107-204, 116 Stat 745.

371 Belgian Corporate Governance Code 9 December 2004, German Corporate Governance Code (The Cromme Code) 26 February 2002, Amendment to the German Corporate Governance Code (the Cromme Code) 21 May 2003, The Dutch Corporate Governance Code 9 December 2003 and The English Combined Code on Corporate Governance 23 July 2003.

372 See the theory of the path dependency, which states that forces such as tradition, history and culture were/are very important in shaping law, Lucian A. Bebchuk and Mark J. Roe, 'A theory of Path Dependence in Corporate Governance and Ownership', *Columbia Law School, The Center for Law and Economics Studies, Working Paper no. 131*, November 1999 and Teubner (1998). Also in the literature there was fierce debate on what had caused these scandals and how to prevent these problems in the future. One questioned also if the scandals on both sides of the ocean had different causes and required different solutions. See difference between inside and outside system, J.A. McCahery & J. Armour, *After Enron: Improving Corporate Law and Modernising Securities Regulation in Europe and the US*, Oxford: Hart Pub-

of a well-established system of securities regulation, which until recently did not exist as such in the EU.

Despite the new EU securities regulation, and unlike in the US, where federalisation of corporate law did not emerge, EU regulatory responses seem again to concentrate, as in the early days of the Union, on elaborating EU 'corporate law' rules on governance to protect the interests of investors (shareholders).

The 1972 draft 5th Directive (as amended), however, was withdrawn in 2004. It essentially aimed at harmonising the basics of corporate governance by mandatory 'internal' governance rules: the division of powers between management, supervisors (non-executive directors) and the GMS, as well as accounting to GMS.[373] It overlapped in part with securities law disclosure. Also the recent EU directive on strengthening rights of shareholders as 'members' of the issuer's 'organisation' reveals a similar conceptual overlap with and departure from the FSA securities regulatory programme (that has apparently not yet been completely absorbed).

3.2.5 (New) Self-regulatory corporate governance codes[374]

As stated before, the US response to Enronitis was limited to SOx, namely a series of amendments of the prevailing securities regulation primarily focussing on enhancement of the quality and reliability of corporate disclosure to the market. In the EU, it accelerated and refuelled the corporate governance debate that since its beginning in the US (growing role and activities of institutional investors[375]; exit or voice; liquidity versus control; impact on market for corporate control, disciplining management) had also spread to the EU. As stated before, it accelerated the execution of the EU FSAP agenda and the finalisation of the series of directives and regulations towards the new EU securities regulation. Simultaneously, it gave a new momentum to the development of corporate governance codes that had emerged in several EU Member States. They responded to different events (corporate failures and scandals) and developments (revival of financial markets and pressure

lications 2006. See also article by John Armour and David A. Skeel, 'Who Writes the Rules for Hostile Takeovers, and Why? The Peculiar Divergences of US and UK Takeover Regulation', *ECGI Law Working Paper No. 73,* 2006; and the article by John C. Coffee, Jr, 'A theory of corporate scandals: why the US and Europe differ', *Columbia Law School and Economics Working Paper No. 274,* March 2005.

373 COM (72) 887 final, 18 July 1972, JO C 131/49; EC Bull Supp 10/72. First draft 1972. Last official draft: COM (91) 372 final, 20 November 1991; (1991) OJ C321/9. In 1996, the Commission asked Ernst & Young to consider the relevance of the Draft Fifth Directive in the study it had commissioned on corporate governance. The Commission decided to draw back the proposal on 9 January 2004, OJ C 5/20 (2004), *Vanessa Edwards*, EC Company Law, Oxford University Press, New York 1999, p. 389. Two highly controversial proposals were the mandatory creation of a two-tier board structure (Art. 2 5th Directive) consisting of a managing organ and a supervisory organ and mandatory provisions for employees' representation on the supervisory board for companies with a workforce greater than 500, Art. 4(2)(3). See Vanessa Edwards, *EC Company Law*, New York: Oxford University Press 1999 , p. 388.

374 Weil, Gotshal & Manges, 'Comparative Study of Corporate Governance Codes Relevant to the European Union and Its Member States', *Final Report& Annexes I-III,* January 2002, p. 28, the simplest and most common definition of this sort is that provided by the Cadbury Report (UK), which is frequently quoted or paraphrases: "Corporate governance is the system by which business are directed and controlled".

375 See amongst others B. Black, 'Agent Watching Agents: The Promise of Institutional Investor Voice,' *UCLA Law Review*, Vol. 39, 1992, and J. Coffee, 'Liquidity Versus Control: The Institutional Investor as Corporate Monitor', *Columbia Law Review*, Vol 01, 1991.

of investors on issuers to focus on their interest).[376] The UK Cadbury Code (1992) was a self-regulatory response to the public indignation and concern after the collapse of BCCI and Maxwell and focussed on enhancement of board structure, oversight by NEDs, audit and other board committees and financial reporting, as did subsequent UK codes, finally resulting in the UK Combined Code (Hampel, Greenbury and Higgs Report[377]), now called UK Corporate Governance Code.[378] The last-mentioned, however, also coincided with and reflected the general corporate governance debate and the growing attention and activities of investors and markets to maximise shareholder value.
Whereas these UK codes primarily aimed at 'self-regulation' by the financial community ('City') and focusses on enforcement through the LSE listing requirements, continental jurisdictions followed a somewhat different route. In the Netherlands the 'Forty Recommendations' of the Peeters Committee (1996) were initiated by the Amsterdam Stock Exchange and the Association of Issuers to align governance with the growing percentage of foreign investment in Dutch issuers, recommending transparency and accounting to shareholders. These did not react to corporate scandals but rather aimed at improving governance of Dutch issuers. The 2003 DCGC (Code Tabaksblat[379]) coincided with the fierce national and EU debate on limitation of anti-takeover devices as well as with the outbreak of 'Enronitis'. The Peeters Committee, although designed to produce a self-regulatory corporate governance code, was effectively pushed for by the Government. The DCGC partly rephrased existing corporate law rules, but in fact further combined principles and best practices of the UK Combined Code (also including best practices for dialogue and contacts with institutional investors) with US SOx elements (financial disclosure, certification, in control statements and business controls). The Committee further emphasised its recommendations on statutory restrictions to the use by a target board of anti-takeover devices (the draft 13th Directive was by then pending in the European Parliament). The Code also extended the rights of GMS/shareholders over and above mandatory corporate law, see e.g. Best Practice IV.1.2 DCGCconcerning voting rights on preferred shares and Best Practice IV.1.6 on the discharge of the BoM and SB separately on the agenda for shareholders to vote upon. The 'comply or explain'-rule was enacted shortly afterwards into corporate law (art. 2:391 lid 5 NCC). Meanwhile, the DCGC was amended in 2009 introducing amongst otherthings a response time for the board of a target in case of a hostile takeover attempt (responding to some cases in which hedge funds tried to force the Board to execute break up scenarios).

376 H.H.Voogsgeerd, Corporate Governance Codes, Markt- of rechtsarrangement?, IOR nr. 55, Kluwer: Deventer 2006.

377 Final report of the Committee on Corporate Governance (Gee, 1998), in the final report the Hampel Committee endorsed the 'overwhelming majority' of the recommendations of the Cadbury Committee and of the Greenbury Committee which had reported in the interim on the particular and still controversial subject of directors' remuneration). Hampel's main contribution was to propose, as indeed happened, that the recommendations of the Cadbury and Greenbury Committees, as refined by Hampel, should be brought together in a Combined code.

378 Gower and Davies, Principles of Modern Company Law, 2008, p. 403.

379 The Committee Tabaksblat was initiated by the Minister of Finance and composed in cooperation with VNO-NCW, NCD, VEB, Euronext and, now, Eumedion. The DCGC was published in December 2003 and contained principles and best practice rules. Then in late 2004 the Monitoring Committee Corporate Governance (Frijns Committee) was created to monitor compliance with the Dutch Corporate Governance Code.

The German Cromme Code, in contrast, remained closely linked to the principles of the existing AktG.[380]
As in The Netherlands, the EU in 2002/2003 was involved in a (political) debate on 13th Directive. In its response to the HLG Report (2002), part of which was dedicated to the elimination of takeover barriers, the EU/EC refrained from developing a European code because convergence between the codes of the Member States were already considerable.[381] However, it did react with recommendations on non-executive directors and remuneration (which followed the main lines of these codes).
In spite of the observed convergence, the content of several codes reflect their different tradition and background.[382] So, while the new EU federal securities law as perceived was under way, the EU Member States mainly reacted to the 2000/2001 corporate scandals through 'self-regulatory' governance codes on the edge of corporate and securities law. They varied in nature and status. The UK Code is applicable through the LSE Listing Rules, while the 'comply or explain' rule in the Netherlands was enacted in corporate law. This specific rule was later enacted by the EU into the (corporate law) 4th Directive (§ 46b), but not into the Transparancy Directive.
These various EU codes indeed cover a wide range of best practices for issuers resulting in reporting and disclosure items in issuer's annual reports on, inter alia, board committees, conflicts of interest, but also on issues directly linked to drafting and preparing the accounts (role of audit committees, audit report, internal controls, in control statements, risk factors, strategy discussion, etc.). Their differences largely reflect the different mix of corporate and securities law protection in the Member States. From a US perspective this mix might indeed be regarded as an intrusion (or sometimes extension) of securities law aims (i.e. regulation of process of financial disclosure to the market, protection of investors in the code) into the 'internal affairs' of issuers. However, they were designed and proclaimed separately from the new 'federal' securities regulation. Any influence is hardly perceivable. These codes are non-binding 'best practices', not enforceable rules. Issuers, however, were pressed by the market and investors, sometimes supported – as in the Netherlands – by judiciary decisions resulting in *de facto* application of such 'soft law'. This is not completely surprising in view of the 'legislative' support of the EC's recommendations on non-executive directors and executive compensation ('threatening' to come up

380 Compare Theodor Baums, 'Company Law Reform in Germany', *Journal of Corporate Law Studies* April 2003, p. 143, the government commission adopted the German corporate governance code on February 26, 2002. Amended on May 21, 2003, and more recently on May 26, 2010. By amendment of § 161 AktG by the Transparency and Disclosure Act, entered into force on 26 July 2002, the Code has a legal basis.

381 Weil, Gotshal & Manges, 'Comparative Study of Corporate Governance Codes Relevant to the European Union and Its Member States', *Final Report& Annexes I-III,* January 2002, p. 6 to reiterate there is little indication that code variation poses an impediment to the formation of a single European equity market. Moreover, the various codes emanating from the Member States appear to support a convergence of governance practices. This, taken together with the need for corporations to retain a degree of flexibility in governance so as to be able continuously adjust to changing circumstances, lead us to conclude that the European Commission need not expend energy on the development of a code applicable to companies in the European Union. Ideas about best practices as reflected in the codes should be allowed to develop over time by the business and investment communities, under the influence of market forces.

382 Raaijmakers, *Ondernemingsrecht, Pitlo/Raaijmakers,* Deventer: Kluwer 2006, p. 323.

with a European code upon having assessed the developments) and the standard 'comply or explain'-rule that was made mandatory. Investors were supposed to use their voting power (as a means of 'private enforcement') to compel the board to apply the best practices of such codes. By now issuers have to disclose in their management report (part of the annual accounts) their compliance with the national applicable code under the statutory 'comply or explain'-rules (4th and 7th Directives), enhances by a corporate governance statement (§10 Transparancy Directive).
In summary, it may be clear that these codes are a mix of securities (disclosure) and corporate law (intrusion in different ways and degrees into the internal affairs of issuers). The rules deviate in addition to – apart from the 'comply or explain'-rule – the enforcement (and oversight) mechanisms. In the Netherlands, observance of the CGC is primarily a matter for discussion in the GMS, but non-observance may be the subject of judicial review in an investigation procedure before the Enterprise Chamber of the Amsterdam Court of Appeal (at least if the issuer 'committed' itself to observance).[383] Being linked to LSE Listing Rules, non-observance of the UK Code may, at least theoretically, cause delisting.[384] These differences also influence exposure to shareholder activism – as will be elaborated in chapter 4.[385] In the next chapter, the division of powers against the background of former developments between the board and GMS will be further scrutinised.

3.3 Comparative analysis of the position of investors (shareholders) in the corporate law division of their collective and individual powers and those of the Board in 'public' corporations (issuers)

At least until the outbreak of the still-continuing financial crisis, the general development has been that investors have explored opportunities in global markets to increase returns on their investments. As explained before in par. 3.2, this development went along with institutional investors, pension funds, state wealth funds, private equity firms and not least hedge funds to become more active in using the powers and rights attributed to their capacity of *shareholders,* although in practice different attitudes and policies continue to exist, ranging from passivity to aggressive attacks on the issuers' strategy and policies.[386] Some

383 See e.g. Enterprise Chamber ASMI, LJN: BJ4688
384 Alain Pietrancosta, 'Enforcement of Corporate Governance Code', as Anton Philips Professor 2008-2009, Tilburg University: Oration: 2008-2009
385 In the *ABNAMRO*-case the Amsterdam Business court de facto put the sale of La Salle on hold in the takeover fight for ABN. Interesting is the comparison with the UK, where under the supervision of the Takeover Panel tactical litigation is not allowed.
386 (Activist) shareholders can be distinguished between small private investor, institutional investor as pension funds (or unions) or financial institutions both of them having different perspectives. But also investors with short investment horizon using volatility and inefficiencies in stock trading yet also hedge funds following a strategy of activism to get a maximum return on their invest. Also a competitor that by acquiring percentages finalises a (hostile) takeover, or private equity aiming to take the corporation private can be seen as activist shareholders. See G.T.M.J. Raaijmakers, 'Beleggers, aandeelhouders en de AVA', *Ondernemingsrecht* 2005, nr. 4. Distinguishing between small private investors, investor with short investment horizon aimed volatility and inefficiencies, major mid-term and

may seek 'undervalued' issuers, buy its shares and press the issuer to change its strategy to realise short-term returns on investment.[387] They may present their case in private 'one-on-ones', but also via public disclosure and pressure. Rules on market abuse will preclude/limit any trading on inside information or, conversely, force publication, unless agreement was reached on confidentiality and 'stand still'.[388] Also further action shall include securities law disclosure rules, but usually be based upon their corporate law powers and causes of action, including those on (contested) takeovers. Famous cases may illustrate this (such as in Germany, Deutsche Börse and in the Netherlands, ABNAMRO, Stork and ASMI, in different ways related to acquisition of control). Law appears to matter.
Several codes, setting principles and best practices, were elaborated to address (groups of) investors (International Corporate Governance Network (CGN), Organisation for Economic Cooperation and Development (OECD) and several national codes, such as UKCGC and DCGC). Since this study remains focussed on comparing statutory investor protection by means of securities and corporate law, these codes will not be elaborated on. Nonetheless, in comparing the several systems, reference is made to the princples and best practice of the various codes. A remarkable commonality is their attention on the somewhat vague concept of a 'dialogue' with (the board of) issuers.

3.3.1 Regulation of 'internal affairs' in the US and the EU: remarkable differences

Chapter 2 revealed the emergence of a US-like structure of EU securities regulation focussing on full initial and continuous disclosure to allow the financial markets and investors to continuously and properly assess the value of the issuer's shares, alongside forceful public oversight (SEC) and a federal securities fraud action. Federal corporate law is nonexistent; the focus of corporate state law is not on protection of investors. The preceding paragraphs indicate the differences with the EU where, also after the introduction of the new US like 'federal' EU securities regulation (including public oversight and the assignment for a private action for securities fraud), corporate law (and corporate governance codes) continues to be used as a regulatory tool to protect shareholders (investors), both collectively as a body corporate ('in meeting') and individually (or groups). This seems to rest on the basic assumption that – apart from the new public oversight and enforcement – shareholders are thus provided with tools for 'broad private enforcement' (acting 'in meeting' as well as individually). Thus, the EU still does not fully focus on (enhancement of) its new

long-term investors, strategic and financial participants, public shareholders. see amongst others: G.T.M.J. Raaijmakers, *Nederlandse beursondernemitngen te afhankelijk van financiele markt*, Vrije Universiteit Amsterdam: Oration: 2009; cf.Lynn A. Stout, New Thinking on 'Shareholder Primacy', UCLA School of Law., Law Econ. Research Paper, no. 11-04.

387 Cf. Bill W. Bratton and Michael L. Wachter, 'The Case against Shareholder Empowerment', *University of Pennsylvania Law Review*, vol. 158: 653, 2010, shareholders/investors use that part of the share prize that can be considered as speculative. The board is best equipped to judge the share prize and from that draw a conclusion for the strategy and policy of the issuer. However this does not mean that the board has to follow the prize of the share submissively. John Maynard Keynes has explained this as follows: short-term trading leads us to focus on what the stock market is doing rather on what companies are doing. Consequently, even today, potential restrains on share trading remain topical

388 A.F. Verdam, Het toenemende belang van de voorfase voor de aandeelhoudersvergadering: een goed begin is het halve werk?, Ondernemingsrecht 2004, 156, p. 412-418; S.E. Eisma, Investor Relations (oration) 1998.

'federal' securities regulation, but continues to build on the classic *acquis communautaire* of prevailing corporate law directives.[389] That focus is illustrated by its mandatory 'comply or explain'-disclosure (in the 4th and 7th *corporate* law Directives). And although the EU thus far refrained from using such codes as a regulatory tool, its attitude seems to be somewhat ambiguous (cf 'recommendations' and its plans for governance of financial institutions that may be extended to issuers in genera). It raises the question as to whether (to what extent) the execution of the market-oriented FSAP agenda is hampered by the traditional (collective and individual) corporate law rights of the issuer's investors as 'members' of the public corporation next to the new body of securities law protective rules. Below we will see that such regulatory choices do indeed matter and therefore urge explicit argumentation and discussion. Conversely, harmonisation of *corporate* law rules to protect investors may influence (hamper) regulatory competition and arbitrage, for example by means of different default rules to protect minority shareholders (other than 'federal' disclosure).[390] Making no choice may – as will be explained – result in overlaps as well as different enforcement mechanisms and hence exposure of shareholder activism since this depends on formal powers of GMS and access of individual shareholders to enforcement of corporate resolutions, including proxy solicitation and enforcement of judicial review of corporate policies and strategy.

The basic differences between the US and the EU can already *prima facie* be illustrated by comparing shareholders' rights as attributed by the US MBCA and DGCL (Delaware, the majority of US publicly traded companies is incorporated in Delaware[391]) with the accumulated provisions of EU corporate law directives and national provisions. The MBCA and DGCL limit the (collective and individual) powers of 'shareholders' (remarkably and in contrast to the EU and MS *not* using GMS as notion of a body corporate) to a few major issues: appointment and dismissal of board members, mergers and consolidations,[392] sales, leases or exchanges of all or substantially all of the corporation's property and assets[393] and leaves the use of proxy solicitation to securities law (§ 14 SEA'34).[394] EU and MS corporate law

389 See also the influence of economical concepts as the "agency-theory", seemingly influencing regulatory reforms after corporate scandals as in 2000/2001, par. 3.2 and references to the literature. May 2003-reaction of EC.

390 Cf. Luca Enriques, 'Company Law Harmonization Reconsidered: What Role for the EC', *ECGI Law Working Paper, No. 53*, 2005, the paper concludes that, ideally, the EC should only engage in free-choice and contractual freedom enhancing harmonisation, while recognising that EC lawmakers cannot be expected to espouse such a programme and expressing the no more realistic hope that they will have the courage, in Gérard Hertig's words, "of doing nothing" instead of pursuing their ambitious harmonization agenda.

391 In 2002, Delaware was the domicile of 59% of Fortune 500 firms and 58% of all publicly traded companies, Lucian Arye Bebchuk & Alma Cohen, Firms' Decisions whereto incorporate, 46 J.L. & Econ. 383, 3911 tbl 2 (223). Model Bus. Corp. Act, introduction at xxvii (2002).

392 § 251 (c) DGCL.

393 § 271 (a) DGCL.

394 See Stephen M. Bainbridge, *Shareholder Activism in the Obama Era, UCLA School of Law, Law-Econ Research Paper No. 09-14*, July 2009, p. 11-12, these direct restrictions on shareholder power long have been supplemented by a host of other rules that indirectly prevent shareholders from exercising significant influence over corporate decision making. Three sets of statutes are especially noteworthy: (1) disclosure requirements pertaining to large holders; (2) shareholder voting and communication rules; and (3) insider trading and short swing profits rules. These laws affect shareholders in two respects. First, they discourage the formation of large stock blocks. Secondly, they discourage communication and coordination among shareholders.

provides for a far more extensive list (e.g. appointment/dismissal of directors, alteration of articles of association, changes in capital and share issues, legal merger, de-merger, dissolution, and change of substance and character of the firm, buy-back of shares, passing pre-emptive rights, use of certain anti-takeover devices[395] (grant options on preferred protective shares).[396] Similarly, provisions on boards, indemnification and insurance of its members, corporate reorganisations, exit rules (squeeze out, sell out and appraisal rights) reveal remarkable differences. All these differences are spelt out in the tables attached in the annexes.

This paragraph will explore in more detail the (statutory) division of (collective and individual) powers of investors (GMS) and the board/SB and, hence, both the nature of protection thus provided to investors (as shareholders) and the statutory level and extent of board supremacy, taking into account recent developments that affected the prevailing systems.

One may – validly – argue that a 'black letter' comparison necessarily will conceal: a) market structures and their developments, b) factual dispersion or concentration of holdings, hence, c) different effects of attribution of legal rights to shareholders[397] and d) their enforcement in court. This argument, however, does not invalidate the observation that at end of the day an investor's action, depending on his total position of enforceable legal rights as attributed by the issuer's jurisdiction and charter, may influence the prevailing governance model and board supremacy. Also GMS motions and dialogues outside a formal GMS should be taken into account.[398] Therefore a comparative investigation of his position and rights and those of the issuer's board is indispensible.[399]

3.3.2 Comparison rights of General Meeting of Shareholders as such: preliminary remarks

This paragraph compares the rights of the GMS as such, i.e. as the body corporate within the internal organisation of the issuer. Some preliminary remarks should be made.[400]

395 These can be grounded on statutory devices and devices inserted in the articles of incorporation and the activation thereof. However, they also can have an economical or structural character as other markets in and outside the EU often appear. Structural protection for Dutch listed corporations is merely non-existent and therefore they mainly have to fall back on 'judicial' ways of protection. See Van der Elst, Christoph, Abe de Jong and Theo Raaijmakers, 'Een overzicht van juridische en economische dimensies van de kwetsbaarheid van Nederlandse beursvennootschappen', *Report to the Social and Economic Council of the Netherlands (SER),* 2007, ch.2.

396 The ultimate test for the supremacy of the board is the question of whether the board (BoM/SB) is authorised to protection the corporation against a hostile takeover.

397 NB: in the articles of incorporation, different shareholder types can be set up, e.g. 'one-share one vote'principle can be limited.

398 Also procedural rules such as the possibility to call a meeting, or the requirement to deposit your share upfront a meeting etc. (mechanical) facilitating the exercise of voting rights in GMS are of influence on the supremacy of the board, see also the proxy voting system in the US.

399 Mathias M. Siems, *Convergence in Shareholder Law*, New York: Cambridge University Press, 2008, p. 119, the future of shareholder activism, however, does not depend solely on the regulatory complex that facilitates the position of the shareholders as such, e.g. voting at a general meeting. Instead, what matters is, first, whether the general meeting has important matters to decide freely at all.

400 Mathias M. Siems, *Convergence in Shareholder Law*, New York: Cambridge University Press, 2008, p. 154, that states that for positive law, however, it is not appropriate to assume a direct contractual mandate from shareholders, since that would go beyond the competence granted by statute or in the articles of association.

First, the GMS as a body corporate in the internal organisation of a public corporation in the EU typically follows the pattern of 'association'[401] and is therefore operating as its 'meeting of members',[402] attributed *as such* with the power to decide on basic decisions concerning the constitution of that 'association' (more or less using language of constitutional law[403]). In contrast, the US MBCA and DGCL speak merely of 'the shareholders' and put the board at the centre of the issuer's internal affairs. Consequently, all major decisions have to be initiated by the board; shareholders cannot[404] initiate such decisions. Their primary means for changing the issuer's 'constitution' is to replace the board by a team that will adopt the policies they want (by means of a (hostile) tender offer or a proxy fight). The central position of the board appears also from the fact that, as in the Netherlands, in cases where the articles are incomplete or management is unable to act, no residual competences remains for "the shareholders".[405] Leo Strine wrote: *"The perspective of the corporate law traditionalist is one that recognizes that here is great value to the American, i.e. Delaware, approach to corporation law. This approach invests corporate managers with a great deal of authority to pursue business strategies through diverse means, subject to a few important constraints. These constraints, that stockholders approve certain important transactions such as mergers,*[406] *vote for direc-*

401 Raaijmakers, *Ondernemingsrecht, Pitlo/Raaijmakers,* Deventer: Kluwer 2006, p. 376. Cf. also E.J.J. van der Heijden and W.C.L. van der Grinten, *Handboek voor de Naamloze en de Besloten vennootschap* (elfde druk), W.E.J. Tjeenk Willink, 1989, p. 365.

402 Mathias M. Siems, *Convergence in Shareholder Law*, New York: Cambridge University Press, 2008, p. 62 the association-membership view is marked by the notion that in any association individuals come together in order jointly to pursue an objective that would be precluded to each of them individually. Here, the legal relations among shareholders, as well as between shareholder or management and the association, play a decisive part. Membership as a special legal relation thus gives the shareholders rights vis-a vis the company. Moreover, the association, rendered autonomous vis-à-vis it members, counts, so that its purpose and functionality may set bounds to the exercise of shareholder rights. For the public corporation with shares traded on a regulated market this metaphor of the shareholder "as member of an association" seems to contradict and give some frictions when the shareholder is seen above all as investor. Viewing the shareholder as member of the association relates to concepts as "shareholder democracy", in which shareholders are seen as the "parliamentarians" of the company and thus as its highest body. Cf als supra note 14, p. 64 where Siems refers to Peter O. Mülbert, *Aktiengesellschaft, Unternehmensgruppe und Kapitalmarkt,* 2nd edition, Munich: Beck 1996, pointing out that capital-market-oriented features can be identified in the German Companies Act 1965 (GerAktG). He therefore sees the shareholders in a hybrid dual role as association member as well as investor, which has also to be taken into account in interpreting the German AktG. However it seems that German legislator as in the US has made a conscious choice to protect investor mainly through securities law. NB: in the articles of incorporation different shareholder types can be set up, by that one can differentiate from e.g. the 'one-share one vote 'principle', a principle applied in the examined jurisdiction. Shareholders mostly is given the chance to vote when rights are changed attached to their class of shares, see § 10.04 MBCA, § 242 (b) (2) DGCL, art. 25 (3) 2nd Directive 77/91/EEC, sec. 630 UK CA 2006, § 179 (3) AktG, art. 2: 122 NCC.

403 Such as "shareholders democracy" or oligarchic regulations.

404 Stephen M. Bainbridge, The Case for limited Shareholder Voting Rights, *UCLA Law Review*, Vol. 53, pp. 601-636, 2006, p. 2 indeed, the extent to which corporate law is stacked against what Bebchuk calls 'intervention power' goes beyond just the housekeeping rules; much of both corporate and securities law serves to sharply limit shareholder involvement in corporate decisions making. See Sofie Cools, 'The Real Difference in Corporate Law between the United States and Continental Europe: Distribution of Powers', *Delaware Journal of Corporate Law, Vol. 30, No. 3,* 2005, p. 44.

405 Cf. § 8.01 (b) MBCA and § 141 (a) DGCL with e.g. art. 2:107 NCC.

406 § 251 DGCL.

tors annually,[407] *and have access to books and records;*[408] *that stockholders can hold managers accountable for failing to fulfill their fiduciary duties; and that state and federal policies give independent directors the clout and duty to police corporate insiders are vital. They provide assurance that managers will not abuse the powers granted to them, thereby instilling confidence in investors that capital may be safely entrusted to corporations run by centralized management. Importantly, potent federal laws requiring accurate accounting and periodic reporting of material financial information and subjecting corporate insiders to criminal and civil liability for fraud supplement state protections for public companies.*[409] *The traditionalist recognizes the need for protections of this kind and the reality that developments in the business world might give rise to a need to strengthen or modify them."*[410] And Lucian Bebchuk, taking another perspective wrote: *"The division between shareholders and board is considered a long-standing, basic feature of American corporate law, the preclusion of shareholders from intervening to adopt changes in the company's basic governance arrangements or to make major business decisions. The legal rules that tie shareholders´ hands and insulate management from shareholder intervention partly account for the power of management and the weakness of shareholders in such companies."*[411] Secondly, GMS resolutions have to be taken with quorum and majority requirements,[412] in

407 § 211 DGCL Stockholders may also remove directors between annual meetings, although they may only remove the members of a staggered board for cause unless the articles of incorporation provides otherwise, § 141 (k) DGCL.

408 § 220 DGCL

409 §§ 13 (a), 13 (i), 32 (a) SEA '34; Corporate Criminal Fraud Accountability Act of 2002, 18 U.S.C.A. § 1350 (2004), 15 U.S.C. §§ 78m, 78ff (2001).

410 Leo E. Strine, jr., 'Towards a true Corporate Republic: A Traditionalist Response to Lucian's Solution for Improving Corporate America', *Harvard Law and Economics Discussion Paper, No. 541,* February 2006, p. 7.

411 Lucian Arye Bebchuk, 'The Case for Increasing Shareholder Power', *Harvard Law Review*, Vol. 118. No. 3, p. 933-914, January 2005. This article reconsiders the basic allocation of power between board and shareholders in publicly traded companies with dispersed ownership. US corporate law has long precluded shareholders from initiating any changes in the company's basic governance arrangements. His analysis and his empirical evidence indicate that shareholder's existing power to replace directors is insufficient to secure the adoption of value-increasing governance arrangements that management disfavours. He puts forward an alternative regime that would allow shareholders to initiate and adopt rules-of-the-game decisions to change the company's charter or state of incorporation. Providing shareholders with such power could operate over time to improve all corporate governance arrangements. Cf. Bainbridge and Strine, who react fiercely on Bebchuk's therory and adhere the Board's primacy model. Leo E. Strine, jr., 'Towards a true Corporate Republic: A Traditionalist Response to Lucian's Solution for Improving Corporate America', *Harvard Law and Economics Discussion Paper, No. 541,* February 2006; cf. Stephen M. Bainbridge, Director Primacy and Shareholder Disempowerment, University of California, Los Angeles School of Law, Research paper No. 05-25.

412 Reinier R. Kraakman, Paul Davies, Henry Hansmann, Gerard Hertig, Klaus J. Hopt, Hideki Kanda & Edward B. Rock, *The Anatomy of Corporate Law, A Comparative and Functional Approach*, New York: Oxford University Press 2004, p 41, a final dimension of the extent of shareholder influence over corporate appointments concerns the ability of the shareholder majority to surmount its own collective action problem. Whenever corporate ownership is splintered among numerous shareholders, the law can enhance or diminish shareholder influence by facilitating or deflecting collective action by the shareholder majority. Cf Mathias M. Siems, *Convergence in Shareholder Law*, New York: Cambridge University Press, 2008, p. 169, as with the governing bodies of political organisations or other associations, for the general meeting the question arises of what majority justifies attributing the decision to the whole organisation. The room for manoeuvre here ranges from a requirement for unanimity to a relative majority of shares entitled to vote. Mathias M. Siems, *Convergence in Shareholder Law*, New York: Cambridge University Press, 2008, p. 169, for shareholders, quorums or qualified majorities sometimes constitute a compromise between the more cumbersome unanimity principle and the

various EU Member States under certain conditions they may typically be annulled, which forms a major element in the enforcement of the rights of the GMS.[413]

Thirdly, the comparison of GMS rights and powers does not – of course – reflect differences between shareholders (small, institutional investors, pension funds, hedge funds) nor types of shares.[414]

Fourthly, neither does it reflect the attendance of shareholders to meetings. Attendance and absenteeism of shareholders at the GMS is and has been a major topic in the recent corporate governance debate. The underlying presumption is that better attendance of shareholders at the GMS and thus less absenteeism results in more 'shareholder democracy' and therefore better 'checks and balances' in the governance organisation within the corporation. This idea suits the EU public corporation in which the GMS typically follows the pattern of 'association' and therefore is operating as its 'meeting of members'. Also in EU corporate governance codes, the idea of better 'shareholder democracy' has been translated into principles and best practices, see for example the Best Practise IV.1 DGCC, which states: "Good corporate governance requires the fully-fledged participation of shareholders in the decision-making in the general meeting. It is in the interest of the company that as many shareholders as possible take part in the decision making in the general meeting. The company shall, in so far as possible, give shareholders the opportunity to vote by proxy and to communicate with all other shareholders, and 'the general meeting should be able to exert such influence on the policy of the management board and the supervisory board of the company that it plays a fully-fledged role in the system of checks and balances in the company." As will be elaborated in par. 3.6, in the US the proxy system (solicitation and voting) as regulated in the SEA'34 and Rules mainly has a disclosure function protecting investors by enabling them to make an informed vote. The US system is less based on rules on convocation and agenda setting. In the case of US public companies, proxies are so

principle of the simple majority. Several topics are playing a role, first there is the question of how to take account of abstentions, secondly, there is sometimes a requirement for a minimum proportion of all shareholders with voting rights in order for a resolution to be valid, thirdly, in most legal systems, supermajorities are required for particular decisions. Quorum and qualified majorities can be seen as instruments underpinning "shareholder democracy", ensuring that all or at least major decisions are supported by a clear majority of shareholders, so that decision-making is enhanced and random majorities avoided. In public corporations with dispersed holdings as in the US quorums and qualified majorities sometimes are hard to obtain. That is one of the reasons a sophisticated system of proxy solicitation and voting has been developed in the US. The protection of investors through sale of their shares on the market and appraisal rights in stead of qualified majorities, suits the US investor oriented system better.

413 See e.g. art. 2:15 NCC.

414 Mathias M. Siems, *Convergence in Shareholder Law*, New York: Cambridge University Press, 2008, p. 66-67, who makes a classification of several types of shareholders; A typology of shareholders is possible from various stand points. From theoretical viewpoints, the models of the shareholder as owner, quasi-partner, association member, parliamentarian, investor and bystander can be distinguished. Since reality does not exactly reflect these models, further indications have been given of various real types of shareholder, where differentiation may for instance be made according to duration of investment, extent of involvement or the person of the investor. This also includes the possibility of addressing different types of shareholders through the articles of association. In this part of the research I take notice of the existence of these different types of shareholders in real world, however I focus on the position of the board, its supremacy and discretion, and how that position is affected by investor searching for investment opportunities and using shareholders law to put pressure on the board, e.g. to change it strategy.

intensively used that the notion of personal attendance at general meetings is regarded as a myth.[415] For a US listed public corporation, the proxy rules put the proxy machinery in the hands of the management/board.[416] This system matches the investor-oriented US system as provided in the Securities Acts and strong board supremacy and discretion under state law (US MBCA and DGCL), which still prevails.[417]
Fifthly, the effectiveness of voting rights (and also of the sale of shares) depends on investors being adequately informed about the issuer and the identity of fellow shareholders to foreclose 'hidden actions' by management. Here, again, securities law disclosure is crucial. However, information rights vested in corporate law also play a role, for example the right to demand information at the GMS, such as art. 2: 117 NCC, a right of the GMS to be informed by the board/SB, and § 131 AktG,[418] an individual right of a shareholder to be informed.[419] Compare also the US shareholder right of inspection of records and books, § 16.02 MBCA and § 220 (c) DGCL.[420]

3.3.3 GMS: appointment, nomination, compensation and dismissal of directors

Appointment and dismissal of members of the board (BoM or SB members) constitute the most important powers in the internal affairs of issuers: since the board 'controls' the strategy and policies of the firm, 'control' over the board is crucial. Control in that sense is typical for subsidiaries and closely held firms; it is not so in the organisation of issuers with dispersed ownership.
A distinction has to be made between selection and nomination of board members (and officers), the act of appointment and setting the terms of employment (terms of office, expiration, re-eligibility, compensation, terms of retirement in case of a (hostile) takeover). Appointment is typically a right of the GMS, although there are exceptions (German AG and a few issuers in the Netherlands under the 'structuurregime').
The process of selection and nomination cannot be handled by the collectivity of dispersed shareholders. It is a major responsibility of (a special committee from) the NED or the SB to select and nominate candidates. However, evidently (large, activist) shareholders may be

415 Mathias M. Siems, *Convergence in Shareholder Law*, New York: Cambridge University Press, 2008, p. 103 and the reference made to *Stoud v. Grace*, 606 A 2d 75, 86 (Del. Supr. 1992) ('Realities in modern corporate life have all but gutted the myth that shareholders in large publicly held companies personally attend their annual meetings').

416 Mathias M. Siems, *Convergence in Shareholder Law*, New York: Cambridge University Press, 2008, p. 107 See also other literature.

417 See however Mathias M. Siems, *Convergence in Shareholder Law*, New York: Cambridge University Press, 2008, p. 107 who argues that the US system from a theoretical viewpoint, this would be justified only if the shareholders and investor' were to be merely spectators, with no active involvement in the firm. Siems states that it is better, however, to grant even the 'shareholder as investor' certain participatory rights, so as to ensure the value of his shares an the quality of the conduct of business. However also in the US system shareholders have certain rights to vote on major issues, e.g. that stockholders approve certain important transactions such as mergers, vote for directors annually, and have access to books and records.

418 Mathias M. Siems, *Convergence in Shareholder Law*, New York: Cambridge University Press, 2008, p.122 it is argued that § 131 AktG additionally is aimed at protecting the shareholder as investor.

419 Mathias M. Siems, *Convergence in Shareholder Law*, New York: Cambridge University Press, 2008, p. 119.

420 Cf. § 131 AktG.

interested in the nomination of new directors, specifically if they want to replace an underperforming board and change the strategy and policies of the corporation in a break up, share buy-back or similar scenario.[421] Direct access to the ballot therefore is fiercely debated generally as well as in particular cases. On the one hand, the board should be allowed to defend the corporate bastion and have the discretion to execute long-term strategy/policy without pressure to be thrown out of office with its potential corresponding liability. On the other hand, staggered boards with, the possibility to take protective measures are seemingly a part of the explanation for 'loss' in shareholder value. However research results are mixed. (proxy contest on the cheap!)Without taking a position in the above debate, the first question is how easy or difficult it is to replace and appoint board members (BoM/SB) in the various systems.[422] Similarly, setting the conditions for service as board members and officers came under pressure.

United States. In the US, § 8.08 (a) MBCA, the plurality of the shareholders and § 141 (k) DGCL,[423] the holders of a majority of the votes (then entitled to vote at an election of directors), may remove any director or the entire board with or without cause (§ 141 (k) DGCL).[424] See the annexes (table comparison shareholder rights) under 'Removal of Directors' for differences between the MBCA and DGCL, also related to the use of staggered boards and cumulative voting.[425]

421 See e.g the Netherlands cases of *Hermes v. ASMI* and *Centarus versus Stork.*

422 Mathias M. Siems, *Convergence in Shareholder Law*, New York: Cambridge University Press, 2008, p. 157 A member leaves the board when his term expires or he is dismissed. For the securing of shareholder interests, both events are of decisive importance. If board members are untouchable because of long terms and lack of power of dismissal, the danger exists that the management can without risk pursue the interests of other stakeholders or its own, at its discretion. However, this is something different that shareholder with only a certain percentage of the shares already acquire effective control without paying a premium.

423 § 141 (k) DGCL Any director or the entire board of directors may be removed, with or without cause, by the holders of a majority of the shares then entitled to vote at an election of directors, except as follows.

424 Allen, Kraakman and Subramanian, Commentaries and Cases on the Law of Business Organizations, Aspen Publishers, New York, 2007, p. 180, corporate law facilitates the election of directors by creating a flexible framework for holding the annual meeting of shareholders. Generally, the state statutes fix a minimum and maxi-mum notice period (e.g., 10-60 days § 222 (b) DGCL) and quorum requirement for the general meeting (§ 216 DGCL). The statutes also establish a minimum and maximum period for the board to fix a so-called 'record date'. shareholders who are registered as of the record date are legal shareholders entitled to vote at the meeting (e.g. DCGL § 211 (c)). Within the range of alternatives permitted by statute, a corporation's actual notice period, quorum requirement, and record date will be established by the charter or in a bylaw.

425 § 8.06 MBCA allowing the practise of 'classifying' the board or 'staggering' the terms of directors so that only one-half or one-third of them are elected at each annual shareholders' meeting and directors are elected for two or three-years terms rather than one-year terms. The traditional purpose of a staggered board has been to assure the continuity and stability of the corporation's business strategies and policies as determined by the board. In recent years the practise has been employed with increasing frequency to ensure that a majority of the board of directors remains in place following a sudden change in shareholding or a proxy contest. It also reduces the impact of cumulative voting since a greater number of votes is required to elect a director if the board is staggered than is required if the entire board is elected at each annual meeting. A staggered board of directors also can have the effect of making unwanted takeover attempts more difficult, particularly where the articles of incorporation provide that the shareholders may remove directors only with cause or by a supermajority vote, or both.

§ 8.03 (c) US MBCA and § 211 (b) DGCL the shareholders by plurality vote (§ 7.28 (a) MBCA) must each year elect the directors, however staggered boards (§ 8.06 MBCA), cumulative voting[426] (§ 214 DGCL) and the proxy machinery, usually controlled by the board, result in board members being elected from a list of eligible candidates set by the board.[427] Electing (nominating) other ('own') candidates is therefore considered to be burdensome.
Shareholders may start a proxy fight, but that procedure is rather expensive in view of the securities law rules that have to be observed amongst other things. The SEC did propose allowing shareholders to come with their own slate of directors back in 2003 (SEC Rule 14a-11).[428] This rule has recently been enacted by the SEC, however it is not yet effective. Under this new Exchange Act Rule 14a-11, companies are required to include a shareholder nominee or nominees for director in the company proxy materials, if the shareholder meets certain conditions, and if the shareholders are not otherwise prohibited — either by applicable state or foreign law or a company's governing documents — from nominating a candidate for election as a director.[429]
This new rule could be enacted under the new Obama administration. It can be regarded as a first battle won for the proponents such as Lucian Bebchuck of shareholder access to the ballot. Others, such as Stephen M. Bainbridge and Martin Lipton, on the other side of the spectrum, consider this kind of amendment to be an erosion of long-standing US principles of board supremacy and discretion, in the long run also producing less shareholder value and, as regards the 2007/2008 financial crisis, not a proper analysis or answer. [430]
European Union. The EU draft 5th Directive (13-12-1972/C 131/49),[431] harmonising the complete internal affairs of all 'public corporations' (note: *not* issuers), by mandatory division

426 By using cumulative voting (minority) shareholders can pool their votes and elect a candidate opposite to the candidate of the corporation, see § 214 DGCL. Stephen M. Bainbridge, *Corporate Law*, 2nd Edition, Foundation Press, New York 2009, p. 236, cumulative voting, however, is not frequently used in issuers.

427 See Stephen M. Bainbridge, 'Shareholder Activism in the Obama Era', UCLA School of Law, *Law-Econ Research Paper No. 09-14*, July 2009, p. 3 referring to Bayless Manning, Book Review, 67 Yale L.J. 1477, 1485-89 (1958), already describing that in practice, of course, even the election of directors (absent a proxy contest) is predetermined by the existing board nominating the next year's board.

428 See very interesting debate on board elections enfolding during Symposium held by Harvard University, Lucian Bebchuk (editor), 'Symposium on Corporate Elections', *Harvard, John M. Olin Center for Law, Economics, and Business, Discussion Paper no. 448*, 11, 2003, the symposium brought together SEC officials, CEOs, directors, institutional investors, money managers, shareholder activists, lawyers, judges, academics and others to discuss the subject from a wide range of perspectives. See also Grechten Morgenson, 'Who's Afraid Of Shareholder Democracy?' *The New York Times*, October 2, 2005.

429 17 CFR Parts 200, 232, 240 and 249, release Nos. 33-9 136; 34-62762; IC-29384; File No. S7-10-09, RIN 3235-AK27 Facilitating Shareholder Director Nominations.

430 Cf. Bill W. Bratton and Michael L. Wachter, 'The Case against Shareholder Empowerment', *University of Pennsylvania Law Review*, vol. 158: 653, 2010. Cf. also Wachtell, Lipton, Rosen & Katz, 'Some thought for Boards of Directors in 2008', *AEI Legal Center – Briefly, Vol. 11, No. 7,* 2008 highlighting some of the significant issues that boards of directors of US companies face in 2008, including tremendous pressures to realise short-term stock-market gains at the expense of long-term value. These pressures have become acute as hedge funds and other activist shareholders, as well as influential proxy advisory firms, have sought to reshape the landscape in ways that undermine the board-centric model of governance. In addition, this memorandum highlights some issues and practical considerations for directors to bear in mind in reviewing the roles, duties and procedures of boards and board committees.

431 COM (72) 887 final, 18 July 1972, JO C 131/49; EC Bull Supp 10/72. First draft 1972. Last official draft: COM (91) 372 final, 20 November 1991; (1991) OJ C321/9. In 1996, the Commission asked Ernst & Young to consider the relevance of the Draft 5th Directive in the study it had commissioned on corporate

of powers between management, supervisors (non-executive directors) and the GMS, was withdrawn, because of disagreement on labour participation, in 2004.[432] Art. 13 sub 1 states that the members of the management organ may be dismissed by the supervisory organ and art. 13 sub 2 states that the members of the supervisory organ may be dismissed at any time by the organ or persons who appointed them and under the same procedures.[433] Art. 3 states that SB will appoint members of the BoM. Art. 4 sub 1 states that for companies which employ five hundred staff or more, the members of the SB, shall (sub 2), be appointed by the general meeting, and not less than one third of the members of the SB shall be appointed by the workers or their representatives or upon proposal by the workers or their representatives.[434] This draft was withdrawn in 2004 since it had become obsolete by the shift in to the corporate governance debate.

United Kingdom. Sec. 168 UK CA 2006 gives the GMS the ability to remove directors at any time by ordinary resolution, also, in contrast to the US,[435] when the articles provide for a staggered board, replacement is still always possible.[436] The UK appointment process which is regulated predominantly by the company's articles of association is opposed to the right of removal.[437] The UK CA 2006[438] requires neither that directors be elected by the shareholders in the GMS nor that they submit themselves periodically to re-election by the

governance. The Commission decided to draw back the proposal on 9 January 2004, OJ C 5/20 (2004), Vanessa Edwards, *EC Company Law*, New York: Oxford University Press 1999, p. 389. Two highly controversial proposals were the mandatory creation of a two-tier board structure (Art. 2 5th Directive) consisting of a managing organ and a supervisory organ and mandatory provisions for employees' representation on the supervisory board for companies with a workforce greater than 500, Art. 4(2)(3). See Vanessa Edwards, *EC Company Law*, New York: Oxford University Press 1999 , p. 388.

432 Cf. the famous debate on the 'race to the bottom' initiated by professor R.K.Winter: R.K. Winter, 'State Law, Shareholder Protection, and the Theory of the Corporation', 6 *J. Legal Stud.* 251, 1977; Cf. Frank H. Easterbrook, The Race for the Bottom in Corporate Governance, Inaugural Ralph K. Winter Lecture, *Yale Law School* (Dec. 5, 2005); See for analysis of competition between federation and the state, e.g. Delaware, for enacting corporate law: William W. Bratton and Jospeh A. McCahery, 'The Equilibrium Content of Corporate Federalism', *Georgetown Law and Econ. Research Paper,* 606481,2004.

433 Art. 13 sub 2, 'However, the members of the supervisory organ who were appointed by it under Art. 4(3) may be dismissed only where proper grounds for dismissal are found to exist by judgment, of the court in proceedings brought in that behalf by the supervisory organ, the general meeting or the workers' representatives.

434 In case the SB members are not appointed by the GMS or workers representatives, (sub 3), the SB shall be appointed by that other organ, however the GMS or the representatives of the workers may object to the appointment of a proposed candidate on the ground either that he lacks the ability to carry out his duties or that if he were appointed there would, having regard to the interest of the company, the shareholders or the workers, be imbalance in the composition of the supervisory organ. In such cases the appointment shall not be made unless the objection is declared unfounded by an independent body existing under public law, (sub 4), as regards companies which employ a lesser number of workers than that fixed in pursuance of paragraph 1 the members of the SB shall be appointed by the GMS.

435 § 141 (k) DGCL provides that when the board is classified directors can be removed only 'for cause', unless the charter provides otherwise.

436 The articles may provide that directors shall be appointed for three years at a time and that no more than one third of the board comes up for election in any one year, in the US these arrangements are referred to as 'staggered boards'.

437 Gower/Davies, Principles of Modern Company Law, Sweet & Maxwell, London 2008, p. 379

438 Gower/Davies, Principles of Modern Company Law, Sweet & Maxwell, London 2008, p. 378 the CA main concern is to give publicity to those who are appointed rather than to regulate the appointment process.

shareholders.[439] The articles of public companies normally provide for retirement of board members by rotation on a three-year cycle (see art. 20 Model Articles for Public Companies, hereafter: MAPC) and for the filling of the vacancies at each annual general meeting.[440] The sec. 160 UK CA 2006 provides that each appointment in a public company shall be voted on individually. The company's articles often provide provisions which make it difficult for shareholders to put up candidates against the board's nominees. As the appointment process is predominantly regulated by the company's articles of association, is would not be a breach of any mandatory rule for the articles to provide that none of the directors should be required to stand for re-election and that the existing directors, without shareholder sanction, should choose any replacements for directors who resigned or were removed. Thus, in theory shareholders could be wholly written out of the appointment process. In practice such extreme cases are rare, though for reasons that reflect market rather than legal constraints as large companies might find it difficult to sell their shares to institutional investors on the basis of such articles.[441] Also taking into account, secs. A.4 and A.7 'Re-election' UK CC, all directors should be submitted for re-election at regular intervals, and all directors should be subject to election by shareholders at the first GMS after their appointment, and to re-election thereafter at intervals of no more than three years. So, the crucial decisions for the shareholders in public companies are normally whether to accept the board's nominees for election at the annual general meeting and whether subsequently to exercise their removal rights.[442]

Germany. Directors (BoM) (§ 23 (5) AktG) can only be replaced for urgent cases; such as the withdrawal of confidence (unsachlich) in them by the GMS.[443] Dismissal of supervisory board members is, unless otherwise provided in the articles of association, possible only by three-quarters of the votes cast, unless there is overriding justification (§103(1), (3) AktG). The board (Vorstand) of an AG is not appointed by the GMS, but by the Supervisory Board (SB, 'Aufsichtsrat'), [444] [445] (§ 84 AktG) for terms of five up to years, re-election is allowed (§ 84 (2) AktG). § 33 'Mitbestimmungsgesetz' requires that a labour director (Arbeitsdirector) is appointed to the Vorstand.[446] However, sec. 5.1.2 GGCC advises that for first-time appointments, the maximum possible appointment period of five years should not apply. A re-appointment prior to one year before the end of the appointment period with a simultaneous termination of the current appointment shall only take place under special circumstances.

439 Gower/Davies, Principles of Modern Company Law, Sweet & Maxwell, London 2008, p.379; § 12 UK CA 2006, initial registration to Reg. of Com; particulars of first directors with foundation of a company.

440 Model public company articles, art. 20 directors appointed by ordinary resolution or by decision of the directors and art. 21 retirement of directors through rotation.

441 Gower/Davies, Principles of Modern Company Law, Sweet & Maxwell, London 2008, p. 389.

442 Gower/Davies, Principles of Modern Company Law, Sweet & Maxwell, London 2008, p. 380.

443 Karsten Schmidt, *Gesellschaftsrecht*, Heymans 2002, p. 808

444 Aktiengesetz, Kommentar, p. 965, Die Beschrankung des Widerrufsrechts unterstutzt die Stellung des Vorstands unde dessen aufgabe, das Unternehmen unabhangig und eigenverantwortlich zu leiten. Weder die Satzung noch die Hauptversammlung kann dem Aufsichtsrat die befugnis zum jederzeitigen Widerruf einraumen.

445 Aktiengesetz, Kommentar, p. 946, the allocation of the power to appoint and replace the directors to the SB expresses the opinion in 1937 that the SB is better suited to appoint the directors than the GMS (Hauptversammlung). See also 108 for decision of the SB.

446 §§ 33 MitbestG, 13 MontanMitbestG, 13 MitbestG.

Shareholder influence (GMS) is limited, since the SB itself is not completely appointed by the GMS, since the SB consists in part of shareholder and of employee representatives. In 'large' corporations, employing more than 2000 employees, the formula is 50/50, but the chairman, who has a casting vote, is elected from the shareholders representatives. The shareholder representatives to be appointed by the GMS are in practice *nominated* by the SB in office and the management board.[447] So, according to § 101 (1) AktG, the GMS elects part of the SB, the rest are appointed by representatives of the employees by virtue of §§ 6-24 Mitbestimmungsgezetz. For an AG employing more than 500 but less than 2000 employees, two thirds of the SB members are appointed by the GMS and one third by the employees (Betriebsverfassungsgesetz).

The Netherlands: each director (BoM) may, at any time, be suspended and removed by the body empowered to appoint him, namely the GMS or SB, (arts. 2:134 (1) NCC and 2:144 and 147 NCC).[448] The articles of incorporation may provide that the resolution to suspend or remove a director (BoM/SB) may only be passed by an increased majority (arts. 2:134 (2) NCC; and 144 (2)).[449] Another route for dismissal of a director is provided by the Netherlands Enterprise Chamber (Amsterdam) by way of 'injunctive relief' (art. 2:349a NCC) or final 'provision' 356 NCC in case of well-founded reasons to doubt good policy on the part of the corporation or, in case of mismanagement of the corporation (for further elaboration on this unique procedure, see chapter 4). The GMS appoints (art. 2:132 NCC) directors,[450] unless the issuer is a 'structuur-NV' where the SB appoints the board members according to art. 2:162 NCC.[451] There are very few such issuers (since the regime does not apply if more than half of all employees are employed outside the Netherlands, which for practically all issuers is the case). If the issuer has a supervisory board (no structuur-NV), its members are appointed by the GMS (art. 2:142 NCC).[452]

The articles of incorporation may limit the power of the GMS to appoint the members of the board by *binding* nominations.[453] In that case the board (BoM/SB) may put a binding nomination of two candidates per vacancy on the agenda: art. 133 (1) (2) NCC. The GMS can waive the

447 Mathias M. Siems, *Convergence in Shareholder Law*, New York: Cambridge University Press, 2008.

448 Art. 2:147 (2) The suspension may be set aside by the general meeting at any time, unless the power to appoint directors is vested in the supervisory board.

449 Art. 2:134 (2) NCC If the articles provide that the resolution to suspend or remove may only be passed by an increased majority in a general meeting at which a specific part of the capital is represented, such increased majority may not exceed two-thirds of the votes cast representing more than one half of the capital.

450 Art. 3 5th Dir. (13-12-1972/C 131/49), Art. 3, SB will appoint members of the BoM.

451 Art. 2:134 (1) NCC: Each director may, at any time, be suspended and removed by the body empowered to appoint him. Art. 2: 162 NCC: The supervisory board shall appoint the directors of the company; this power may not be limited by any binding list of candidates. It shall notify the general meeting of shareholders of an intended appointment of a director of the company. It shall not remove a director until the general meeting has been consulted on the intended dismissal. Art. 2:158 (11) NCC shall apply *mutatis mutandis*.

452 The articles of incorporation (Art. 2:132(2) NCC) may impose requirements which the directors must meet, these however may be waived by a resolution of the general meeting adopted by two-thirds of the votes cast representing more than one half of the issued capital. See art. 2:120 (3) NCC the articles can provide for lighter criteria.

453 B.P.A. Santen and F. Kloosterman, 'Bad governance of goede bescherming? –Benoeming van bestuurders en commissarissen in de niet-structuur-beursvennootschap', *TvOB* 2007-2, p. 49-56, from their research it appears that in the Netherlands the articles of incorporation appear to limit the power of

binding character thereof by two-thirds of the votes cast representing more than one half of the issued capital. Best practice IV.1.1 DCGC advises a limitation to an absolute majority of the casted votes representing one third of the issued shares. Art. 2:120 (3) provides that if a quorum is not reached, a new meeting can be called in which the resolution can be made independently of the present capital, *unless the articles provide otherwise*, in which case the quorum demand shall still be standing.[454]

The articles can for example authorise holders of priority shares to propose such binding nomination. Such shares are often held by the founders of the company, but over time these have often been transferred to the SB. Under pressure of the market, many issuers have dropped such provisions. Compare also Professor Van der Elst, who provides empirical evidence that in the Netherlands the presence of priority shares has declined over recent years.[455] Powers and responsibility have shifted to the supervisory board and its selection and nomination committee.[456] Cf. Best Practice III.5.13 DCGC for selection and nomination committee.[457]

For the very few Dutch issuers that still apply the 'structuur-regime', the supervisory board shall appoint the directors of the company. This power may not be limited by any binding list of candidates. It shall notify the general meeting of shareholders of an intended appointment of a director of the company. It shall not remove a director until the general meeting has been consulted on the intended dismissal (see 2:162 NCC). The GMS for 'structuur' NV appoints, according to a nomination mechanism (art. 2:158),[458] suspends and also removes the commissioners. Since 2004 the law provides for a low threshold to collectively remove the supervisory board, arts. 2:158 (4) and 2:161a NCC. This strengthening of the position of

the GMS to appoint the board members, a major/controlling shareholder does not have the decisive voice.

454 B.P.A. Santen and F. Kloosterman, 'Bad governance of goede bescherming? –Benoeming van bestuurders en commissarissen in de niet-structuur-beursvennootschap', *TvOB* 2007-2, p. 49-56, only a few corporation have that provision in their articles.

455 Raaijmakers, *Ondernemingsrecht, Pitlo/Raaijmakers,* Deventer: Kluwer 2006, p. 394, Van der Elst, Christoph, Abe de Jong and Theo Raaijmakers, 'Een overzicht van juridische en economische dimensies van de kwetsbaarheid van Nederlandse beursvennootschappen', *Report to the Social and Economic Council of the Netherlands (SER),* 2007.

456 B.P.A. Santen and F. Kloosterman, 'Bad governance of goede bescherming? –Benoeming van bestuurders en commissarissen in de niet-structuur-beursvennootschap', *TvOB* 2007-2, p. 52, most of the listed Dutch corporations (not 'structure-regime, 10 out of 50 corporations (AEX and AMX) adhere to the 'structuur-regime'. In 25% the 'prioriteit' is authorized.

457 Raaijmakers, *Ondernemingsrecht, Pitlo/Raaijmakers,* Deventer: Kluwer 2006, p. 394; *Selection and appointment committee;* III.5.13 The selection and appointment committee shall in any event focus on: a) drawing up selection criteria and appointment procedures for supervisory board members and management board members; b) periodically assessing the size and composition of the supervisory board and the management board, and making a proposal for a composition profile of the supervisory board; c) periodically assessing the functioning of individual supervisory board members and management board members, and reporting on this to the supervisory board; d) making proposals for appointments and reappointments; e) supervising the policy of the management board on the selection criteria and appointment procedures for senior management.

458 See art. 2; 158 (4), (5), (6), (7), (9) and (10), with absolute (= 100%) majority of the votes representing 1/3 of the votes the nomination can be breached. So in the election process of SB members also the rights of GMS are strengthened.

the GMS gave (activist) shareholders the possibility, in the case of *Stork*, to put pressure on the board to split up the corporation.[459]

In normal circumstances, the SB will therefore decisively influence the appointment of its own members and of the management board by the GMS. However, in view of Best Practice IV.1 DCGC and art. 2:161a NCC in combination with possible judicial review in the framework of the investigation procedure, the position of the GMS has been strengthened for contested takeovers and attempts to remove allegedly underperforming directors or simply in case of a change of strategy. The low numerical and legal thresholds for initiating an investigation procedure before the Amsterdam Enterprise Chamber opens the possibility for immediate and final injunction (arts. 2:349a and 2:356) to suspend, remove or add SB members in case of well-founded reasons to doubt good policy on the part of the corporation or mismanagement of the corporation (for further elaboration on this unique procedure, see chapter 4). In some major cases this has indeed been by decrees of the Enterprise Chamber and only in part [corrected] by the Netherlands Supreme Court. This means of enforcing shareholder activism deviates from the pattern as described for the US, UK and Germany. Both the SER and the DCGC Monitoring Committee advised limitting these possible actions and changes. The introduction of some form of BJR has in particular been fiercely debated (see further chapter 4).

However, these provisions from 'the law in the books' do not reveal the corporate practice of intermediate dismissal of CEOs and other executives, usually initiated by the non-executive directors.

3.3.4 Board remuneration (annex, under remuneration policy)

In recent years, setting of the conditions for service as board members and officers came under pressure.

On the one hand, alignment (grant of stock options and bonuses) has been promoted to equate with the interests of investors. On the other hand, 'excessive' compensation was fiercely debated. It resulted in a shift of statutory powers from (committees of) the board to the GMS.[460]

459 Court of Appeal (Enterprise Chamber), 17-01-2001, AA 2007, 346, Stork, note M.J.G.C. Raaijmakers; arts. 2:142, 144, 158 (4) 161a NCC.

460 See e.g. art. 2:135 NCC, the GMS will adopt the remuneration policy of the board. Cf. also Wachtell, Lipton, Rosen & Katz, 'Some thought for Boards of Directors in 2008', *AEI Legal Center – Briefly, Vol. 11, No. 7,* 2008, pointing out that executive compensation continues to be a high-profile corporate issue and a major focus of shareholder activism. One aspect of executive compensation reforms that has recently gained traction is the advocacy of "say on pay" policies that call for non-binding shareholder ratification of executive compensation. Both Verizon and Aflac have announced that they will hold a shareholder advisory vote on executive compensation at their 2009 annual meetings. In addition, Pfizer and several other large companies have formed a working group with union and pension funds to discuss adoption of a "say on pay" policy. The issue has likewise gained traction in political forums. Last April, "say on pay" legislation received the approval of the U.S. House of Representatives, and a companion bill was promptly introduced in the Senate. Cf. Jeffrey N. Gordon, 'Say on Pay': Cautionary Notes on the UK Experience and the Case for Shareholder Opt-In', *ECGI – Law Working Paper No. 117,* 2009. Cf. also G. T.M.J. Raaijmakers*, De effectiviteit van regels in het ondernemings- en effectenrecht*, Den Haag: Boom Juridische Uitgevers 2006, p.14, who observes a trend that corporate and securities rules are designed with the aim of certain behavioural affects. He also questions whether lawyers have the proper instruments to achieve that kind of results. In that sense he also questions whether

However in the *US,* the board still has the authority to fix the compensation for directors, § 8.11 MBCA and § 141 (h) DGCL. Again, the basic (governance) assumption is that when directors abuse their authority to set their own compensation, shareholders have the possibility of challenging the level of compensation through a derivative suit cause of breach of the duty of loyalty.[461] According to Item 9-22 of Schedule 14A SEA'34, compensation plans have to be added to the proxy statement and to be disclosed to the market. NYSE Listed Company Manual § 303A.05 requires the board of directors of all listed companies to have a compensation committee. This committee must be comprised solely of independent directors.[462]

EU. The EC Recommendation on Directors' Remuneration (hereafter: 'Recommendation'), as stated in the Preamble, considers the form, structure and level of directors' remuneration as matters falling within the competence of companies and their shareholders. Disclosure is considered as an important mechanism to inform shareholders about the companies' remuneration's policy, but also to make the company and its board accountable to its shareholders. However, no reference is made to the Transparency Directive and the Annual Financial Report. Recommendation sec. II.3.1 states that listed companies should disclose a statement of the remuneration policy of the company (the 'remuneration statement'). It should be part of an independent remuneration report and/or be included in the annual accounts and annual report or in the notes to the annual accounts of the company. The remuneration statement should also be posted on the listed company's website. The Preamble also considers it important that the GMS should have a say in the remuneration of directors. Therefore, sec. II 4.1 states that the remuneration policy and any significant change to it should be an item on the agenda of the annual GMS, and sec. II 4.2 provides that the remuneration statement should be submitted to the annual GMS for a vote, this vote may be either mandatory or advisory, however MS may provide that such a vote will be held only if shareholders representing at least a quorum of 25% request it, unless national law differs, and sec. IV 6.1 on share-based remuneration states that schemes under which directors are remunerated in shares, share options or any other right to acquire shares or to be remunerated on the basis of share price movements should be subject to the prior approval of shareholders by way of a resolution at the annual GMS prior to their adoption.

In the *UK,* the articles 12 and 22 MAPC) provide that the board shall have power to set directors' remuneration (also fees) as executives, the director whose remuneration is at issue is not usually permitted to vote on the matter.[463] No statutory rule requires a shareholder vote nor does the CC recommend this as best practice, however after public concern and

disclosure/transparency is the right tool to tackle perceived problems with director remuneration. Disclosure/transparency made directors' remuneration more comparable, but seemingly resulted in upwards in stead of downwards pressure on directors' remuneration.

461 Cf. Mathias M. Siems, *Convergence in Shareholder Law*, New York: Cambridge University Press, 2008, p. 159.

462 Stephen M. Bainbridge, *Corporate law and Economics (2*nd *edition)*, Foundation Press 2009, p. 85, only listed companies in which a shareholders or group of shareholders acting together own 50% or more of the stock are exempt from this requirement.

463 Arts. 12 and 22 MAPC.

debate over levels of directors' remuneration, the companies legislation was amended[464] and requires that the directors of quoted[465] companies produce an annual remuneration report (sec. 420 (1) UK CA 2006) and an advisory vote of the shareholders on the report (sec. 439 UK CA 2006).[466] However, shareholder approval is required under the Listing Rules (LSE LR art. 9.4 and 9.4.2) for certain share option schemes and other long-term incentive plans for directors, in the case of companies admitted to the official list and traded on the main market of the LSE. Notably, the payment of performance-related remuneration to executive directors is now recommended as best practice by the Combined Code (sec. B.1.3 CC)[467]
Germany: In Germany, the SB decides on remuneration of and loans to directors (§ 87 AktG and 89[468]). The sec. 4.2.2 GCGC recommends that, on the proposal of the committee dealing with BoM contracts, the full SB determines the total compensation for the individual directors and resolves and regularly reviews the MB compensation system. In sec. 4.2.3 GCGC the composition, fixed as well as variable components, of the BoM's remuneration is further elaborated. In general it states that the compensation structure must be oriented toward sustainable growth of the enterprise. The total compensation for each of the members of the management board is to be disclosed by name, divided into fixed and variable compensation components. Disclosure may be dispensed with if the general meeting has passed a resolution to this effect by a three-quarters majority (§ 4.2.4). And disclosure shall be made in a compensation report which, as part of the Corporate Governance Report, describes the compensation system for management board members in a generally understandable way (sec. 4.2.5, see also sec. 4.2.3 and sec. 4.2.4 GCCC). The normal remuneration of SB members is set in articles of association or by the GMS (§ 113 (1) AktG). Where exceptionally an additional consultancy contract is concluded with an SB member, its effectiveness, including the remuneration components, is dependent on assent by the whole SB (§ 114 (1) (2) AktG).[469]
In *the Netherlands* the remuneration *policy* of the company will be adopted by the GMS (art. 2:135 sub 1 NCC[470]). The detail to which this remuneration policy will be determined by the GMS is not clear.

464 These amendments were made after the 2002 Directors' Remuneration Report Regulations (SI 2002/1986).

465 Defined as having equity share capital officially listed in the UK or an EEA Member State or admitted to dealings on the NYSE or NASDAQ: Companies Act 1985, s. 262(1). Cf. Gower & Davies, 2008, p. 385, the purpose of this broad definition is to remove any incentive for British companies to escape the new requirements by listing their securities elsewhere than in London.

466 Gower/Davies, Principles of Modern Company Law, Sweet & Maxwell, London 2008, p. 385. See also Ellis Ferran, 'Company Law Reform in the UK: a Progress Report', *ECGI Law Working Paper 27*, 2005 and L. Roach, 'The Directors' Remuneration Report Regulations 2002 and The Disclosure of Executive Remuneration', 25 *Company Lawyer* 141, 2004 who discusses the disclosure requirements concerning directors' remuneration.

467 Sec. B.1.3 CC, its Main Principle on Remuneration now includes the statement: "A significant proportion of executive directors' should be structured so as to link rewards to corporate and individual performance".

468 Christoph H. Seibt, in K. Schmidt/Lutter (eds.), *Aktiengesetz Kommentar*, 2008, § 87 and § 89, p. 984.

469 Mathias M. Siems, *Convergence in Shareholder Law*, New York: Cambridge University Press, 2008, p. 159-160.

470 Lower House of the Dutch Parliament, 2002-2003, 28 179, no. 31

During parliamentary proceedings, the Minister of Justice made the remark that the GMS has the authority to establish the boundaries in which an organ of the company appointed by the articles can determine the remuneration of the individual director.[471] The remuneration of the directors will be adopted by the GMS according to the remuneration policy of the company, unless another organ is authorised by the articles (art. 2:135 sub 3 NCC). The SB is the most eligible organ, because it will exercise constant supervision of the BoM. In case of share-based remuneration, also when another organ determines the remuneration of the directors, the GMS has to approve a proposal (art. 2:135 sub 4 NCC). If a company has a remuneration committee, Best Practise III.5.9 DCGC states that this committee will present a proposal to the SB concerning the remuneration policy. Chapter 11.2 of the DCGC provides the principles and detailed best practice on directors' remuneration. According to principle and Best Practice II.10 DCGC, the SB, on proposal of the remuneration committee, will determine the remuneration of the individual members of the management board within the scope of the remuneration policy adopted by the general meeting (art. 2:135 sub 1 NCC). The remuneration report of the SB will be posted on the website of the company; this report shall explain how the chosen remuneration policy contributes to the achievement of the long-term objectives of the company and its affiliated enterprise in keeping with the risk profile (Best Practise II.2.12 DCGC[472]). The GMS can adopt the remuneration of the SB members (art. 2:145 NCC and Best Practise III.7 DCGC). To safeguard the independent discharge of their duties Best Practise III. 7 DCGC determines that the remuneration of the individual SB members will not be dependent on the results of the company and a supervisory board member may not be granted any shares and/or rights to shares by way of remuneration (Best Practise III.7.1 DCGC)[473]. (For more detail, see the annexes.)
If we compare the authority to set the remuneration of the board/SB, the US board is most supreme in setting the conditions of its own remuneration. The UK board also has much leeway in setting its remuneration, only UK CA 2006 requires an advisory shareholder vote on the remuneration report and the LSE LR require an advisory shareholder vote in case of share-based remuneration. The Netherlands GMS has the most influence on the remuneration of the BoM/SB as it adopts the remuneration policy of the corporation. However, the Netherlands SB in practice sets the individual remuneration of the board; this equates to the German system where the SB determines the remuneration of the BoM; nevertheless the German GMS has no power to influence the remuneration of the BoM.

471 Upper House of the Dutch Parliament 2003-2004, 28 179, D, p. 7, see also Lower House of the Dutch Parliament 2002-2003, 28 179, no. 51, p 2

472 The remuneration report of the supervisory board shall contain an account of the manner in which the remuneration policy has been implemented in the past financial year, as well as an overview of the remuneration policy planned by the supervisory board for the next financial year and subsequent years. The report shall explain how the chosen remuneration policy contributes to the achievement of the long-term objectives of the company and its affiliated enterprise in keeping with the risk profile. The report shall be posted on the company's website.

473 See also Best Practise III.7.2 DCGC. Any shares held by a supervisory board member in the company on whose board he sits are long-term investments and Best Practise DGCG III.7.3 The company may not grant its supervisory board members any personal loans, guarantees or the like unless in the normal course of business and after approval of the supervisory board. No remission of loans may be granted.

3.3.5 Adoption annual accounts and distribution of dividends from profit

As already discussed in chapter 2, securities disclosure is to be distinguished from corporate law 'accounting'. US securities law focuses completely on initial and continuous disclosure under public oversight and private enforcement (by means of securities fraud actions). EU securities law introduced a similar system (Transparency Directive, Market Abuse and IAS Regulation), but retained its links to corporate law 'accounting' to 'members' (4th/7th Directives), however, without EU provisions on corporate action (adoption by GMS in art. 48(1) of the withdrawn 5th Directive[474]). This results in some remarkable differences in MS' law on adoption, disclosure and restatement of annual accounts.

US: In the US, no accounting to the GMS as an organ of the firm is required, since the annual report serves as a standalone (securities law) disclosure document.

UK: In the UK, the accounts of a PLC are adopted – as in the US – by the board and signed by a director of the company.[475] These will be 'laid before' but not formally adopted by the AGM.[476]

Germany: §§ 170 and 171 AktG require the management of an AG to submit the accounts and report to the SB to be 'prüfed' (reviewed); the SB shall make a report to the AGM (extended with governance items).[477] § 172 AktG *allows* adoption by both the management and SB but the adoption of the accounts that are already 'approved' accounts may be left to the AGM (§ 173 AktG).[478] According to sec. 2.2.1 GCGC, the board submits the annual accounts to the GMS.[479]

Netherlands: Netherlands law sticks to the established 'accounting' tradition by requiring that *all* members of both BoM and SB shall sign the *accounts* and submit these – *also issuers* – for adoption to the AGM (art. 2:101 (2) (3) NCC[480]), not the *MR* which evidently will not be *adopted* by the GMS. Publication through depositing the annual financial report with the commercial register (1st Directive!) shall take place *after* adoption.[481]

474 5th Directive, Art. 48 (1) 5th Dir. the annual accounts shall be adopted by the general meeting, (2) however the laws of the Member States may, however provide that annual accounts shall be adopted not by the GMS but by the management organ and the supervisory organ, unless those two organs decides otherwise or fail to agree. See also 4th/7th Directive and IAS regulation do not provide for an adoption of the annual accounts by the GMS. See however arts. 50b/50c 4th Dir. and 36a/36b Dir7 on *collective duties of the administrative, management or supervisory body* for the accounts and report (accordance to the dir. and for issuers according to IFRS).

475 Sec. 414 UK CA (2006), A company's annual accounts must be approved by the board of directors and signed on behalf of the board by a director of the company.

476 Sec. 437 UK CA (2006).

477 §§ 170 and 171 AktG, BoM of an AG to submit the accounts and report to the SB to be 'prüfed' (reviewed); the SB sends report to the AGM (extended with governance items); §§ 172 and 173 AktG, adoption by either BoM and SB but the adoption accounts ('approved') accounts may be left to the AGM.

478 The AGM resolves anyhow on profit distribution (§ 174 AktG); cf art. 50 4th Dir. and sec. 2.2.1 GCGC (Cromme); cf arts. 2:105 (1) and 2:362 lid 2 (NCC). Note that under Dutch law, distribution of dividends out of profit is held hostage upon adoption by the AGM of the accounts which show that such distribution is permissible (art. 2:105-3 NCC).

479 Sec. 2.2.1 GCGC, The Management Board submits to the General Meeting the Annual Financial Statements and the Consolidated Financial Statements. The General Meeting resolves on the appropriation of net income and the discharge of the acts of the Management Board and of the Supervisory Board. It elects the shareholders' representatives to the Supervisory Board and, as a rule, the auditors.

480 Until 2004 the AGM in a 'structure' company did not *adopt*, but only *approved* the accounts. The Supervisory Board did *adopt* the accounts.

481 See art. 2:101 sub 1 NCC, this can take 13 months in total.

As mentioned, issuers are not exempt, although the annual financial report has to be disclosed promptly after these have been signed by all MB and SB members.[482] This anomaly not only influences the power to require restatement by the AFM, but also the related but disconnected issue of discharge (and liability) of board members.
Note that under Dutch law, payment of dividends (out of the established profit over the fiscal year) is conditional upon adoption of the accounts (art. 2:105 1/3 NCC).[483] The policy on reservation and distribution, especially the maximum, destination and form of reservation, distribution and dividends, shall be put on the agenda for discussion according to Best Practise IV.1.4. DCGC.
In the US (§ 170 DGCL) and the UK (not in act, see art. 69, 69 (2) MAPC recommendation from the board and shareholder approval) the board decides on the distribution of dividends. In Germany the GMS decides (§§ 119 and 174 AktG).

3.3.6 Discharge board members

As already explained in chapter 2, § 7.4 adoption by the GMS of the accounts is based on the idea of 'accounting'.[484] The concept of discharge is embedded in classic corporate law and decision-making in the field of 'accounting'. Thus, traditionally the flipside of proper accounting was a discharge of the board and its members for the fulfilment of their tasks and assignment over the fiscal year for which they had accounted. Such a discharge served as shield against liability vis-à-vis the corporation.[485] Germany and the Netherlands are familiar with the concept of discharge as a general rebuttal in litigation for the personal liability of directors.[486] These jurisdictions envisage, in different ways, the power of the AGM to resolve to discharge management and supervisors for the execution of their assignment in the reporting period.

482 Art. 2:101 (1) NCC With in five months (extension of 6 months by GMS possible) after the end of the financial year, annual accounts drawn up by BoM and lays them down for inspection by the shareholders at the office of the company; (2) all directors and members SB shall sign the accounts; (3) GMS adopts the annual accounts. See ch. 2 for explanation on what grounds prompt disclosure of annual accounts to the market is required.

483 Art. 2:105 (1) NCC: Save as otherwise provided by the articles, the profits shall accrue to the shareholders. 3. Any distribution of profits shall be made after the adoption or approval of the annual accounts from which it appears that the same is permitted.

484 Cf. H.Beckman, *Hoofdlijnen van het Jaarrekeningrecht*, Deventer: Kluwer 2008, p. 3 and p. 7, when a seperation exists between management and owners the lack of an administration prevents a proper accounting towards its owners; therefore there interests will be harmed. See also the interesting fact that US corporate law limits the accounting obligation of *closely* held corporations to keeping financial account, which they are under no duty to disclose publicly, Reinier R. Kraakman, Paul Davies, Henry Hansmann, Gerard Hertig, Klaus J. Hopt, Hideki Kanda & Edward B. Rock, *The Anatomy of Corporate Law, A Comparative and Functional Approach*, New York: Oxford University Press 2004, p. 79.

485 Cf. Raaijmakers, *Ondernemingsrecht, Pitlo/Raaijmakers,* Deventer: Kluwer 2006, p. 423.Cf. however Mathias M. Siems, *Convergence in Shareholder Law*, New York: Cambridge University Press, 2008, p. 155, stating that the possibility of a regular discharge is not a waiver of claims. Waiver of claims is instead often bound up with special requirements (e.g. §§ 93 (4, s.3) 116 AktG) and in any case cannot as a rule be presumed.

486 Discharge is acceptance by the assignor (or his representative) of the accounting by the assignee(s), i.e. in a corporation: discharge of management (board) by the corporation (represented by another body corporate: AGM, SB or NEDs) and thereby releasing them in principle from liability, albeit with certain limitations as set out below. This resembles the position of a trustee vis-à-vis the beneficiaries.

US: Discharge of directors is unknown in the US, since the issuer *as such* is obliged to disclose financial statements and reports, which includes the annual report to shareholders. These are not 'accounting' documents to the GMS and the GMS is not involved in their adoption and, hence, neither in any related 'discharge'. On the other hand, for example the Business Judgement Rule (BJR, see § 8.30 MBCA) serves as a general defence in which directors are sued for directors' liability, also in a derivative suit. The BJR is of course not available in a securities fraud action (§ 10b SEA'34 and Rule 10b-5) since that action is initiated against the issuer as such. Compare also the possibility of indemnification, Delaware (§ 145 (a), (b), (c) DGCL, see also § 8.50 MBCA) prescribes mandatory indemnification rights for directors and officers. The statute authorises corporations to commit to reimburse directors for reasonable expenses for losses of any sort arising from any actual or threatened judicial proceedings or investigation.
UK: The UK CA 2006 does not provide for discharge of directors. Provisions that purport to exempt directors from or indemnify against any liability towards the company in case of negligence, default, breach of duty of trust are void (sec. 232 (1),(2) UK CA 2006). However, sec. 233 UK CA 2006 allows insurance against any such liability as mentioned above.
Germany: German law teaches that according to § 120 AktG, the AGM each year decides on the discharge (Entlastung) of managers and supervisory board members (deciding on the destination of profits implies discharge ('Enlastung') of BM and SB members (§ 120 AktG)),[487] which decision 'billigt der Verwaltung der Gesellschaft', but does not result in a waiver for a claim for compensation ('enthält kein Verzicht auf Ersatzansprüche'). Such claims can be litigated under the general provision on directors' liability (§§ 93 and 116 AktG), also as a derivative suit (§§ 147-149 AktG). The German legislator apparently observed the disconnection between the concept of discharge and the new securities law and did indeed introduce a new business judgement rule in § 116 AktG: '*Eine Pflichtverletzung liegt nicht vor, wenn das Vorstandsmitglied bei einer internehmerischen Entscheidung vernünftigerweise annehmen dürfte, auf der Grundlage angemessener Information zum Wohle der Gesellschaft zu handelen.*'
Netherlands: In 2004, art. 2:101 (3) NCC explicitly disconnected adoption (by the AGM) of the accounts from such discharge.[488] Hence, discharge requires separate GMS resolutions, therefore Best Practise DGCG IV.1.6 makes a further split between management and the supervisory board. So, the accounts may be adopted (the report is not) and discharge of managers and/or SB members withheld. Consequently, its nature seems to change direction according to a 'poll' of present and future strategy and policies, thus extending the powers of shareholders in meeting and diminishing the protection of board members. If so deprived from discharge, no alternative statutory business judgment rule protects management and SB in a later suit for liability which may also follow an investigation procedure. In this case mismanagement of the company may be established on non-compliance with best practices of the CGC. These threats and the reputational damage involved may increase risk-aversive conduct. This departs from the other examined systems; in the US system where the director's right to statutory indemnification and protection of the BJR in a derivative suit shields him from liability; the UK where the court has to allow a derivative

487 Die billigt die Verwaltung der Gesellschaft, aber enthält kein verzicht auf ersatzansprüche.
488 Cf. The Forty Recommendations of the Peters Commission.

suit; and Germany where a new BJR has been introduced. The function of discharge and the unique Dutch procedure with the Amsterdam Court of Business will be discussed further in chapter 4.

3.3.7 Appointment and assignment external auditor

In the US, SOx strengthened the position of the auditor and the audit committee is now mandatory. Public oversight on qualification, quality and ethical standards of registered auditors was introduced (Title I, SOx), auditor independence improved (Title II, SOx), audit and certification procedures in connection with disclosure documents sharpened (Titles III/IV) and analyst conflicts of interest subjected to greater scrutiny (Title V).[489] Auditor's independence from management was amplified as an independent 'public watchdog',[490] to enhance their role as gate-keeping independent experts.[491] In the EU this role was amplified by the revised 8th Directive.[492] On both sides of the Atlantic, the statutory audit is regarded as a fundamental prerequisite for the proper functioning of the securities and capital markets.[493]
US: in the US, the audit committee of the board is responsible for the appointment, compensation and oversight of the work of the auditor.[494]
EU: the EU in art. 51 4th Dir. requires that the annual accounts be audited by one or more persons approved by MS to carry out statutory audits on the basis of the 8th Directive; however a mandatory audit committee is not required. The appointment and assignment of the auditor is not regulated on EU level. Art. 55 (1) 5th Dir. determined that the auditor shall be appointed by the GMS. The 8th Directive (84/253/ECC of 10 April 1984) lays down the conditions for the approval of persons responsible for carrying out the statutory audit and aims at high-level harmonisation of statutory audit requirements (see chapter 2 for further analysis of the 8th Directive).
UK: Secs. 489 (4) and 491 (1) (b) UK CA 2006, states that the GMS has the power to appoint the auditor. There are only exceptional circumstances in which the directors may appoint the auditors, for example sec 489 (3) UK CA 2006 to fill a casual vacancy, after a period in which the company has not been required to have an audit, or before its first accounts meeting.

489 § 501 SOx-Act. Moreover: § 1107, retaliation against informants, § 1102, tampering, § 1001 Corporate Tax Return, etc.
490 Werner F. Ebke, 'Corporate Governance and Auditor Independence: The Battle of the Private Versus the Public Interest', in: G. Ferrarini, K. J. Hopt, J. Winter and E. Wymeersch (eds.), *Reforming Company and Takeover Law in Europe,* New York: Oxford University Press 2004, p. 182.
491 Art. 22 revised 8th Directive (2006).
492 Introducing inter alia public oversight – comparable to the US PCOAB – on approval and withdrawal of auditors and firms, educational standards and qualifications, registration, professional ethics and secrecy, auditing standards and reporting, quality assurance, investigations and proper sanctions on non observance of the standards, the introduction of public oversight and international cooperation. Consequently the audit committee plays a crucial role in the process of drafting, accounting and auditing the accounts and the report.
493 Werner F. Ebke, 'Corporate Governance and Auditor Independence: The Battle of the Private Versus the Public Interest', in: G. Ferrarini, K. J. Hopt, J. Winter and E. Wymeersch (eds.), *Reforming Company and Takeover Law in Europe,* New York: Oxford University Press 2004, p. 514.
494 § 301 SOx adds § 10A (m) to the SEA'34 and expressly directs: the audit committee of each issuer, in its capacity as a committee of each issuer, in its capacity as a committee of the board of directors, shall be directly responsible for the appointment, compensation, and oversight of the work of any registered public accounting firm; cf. also NYSE/NASDAQ rules.

Notably, if a public company fails to appoint an auditor or auditors in accordance with sec. 489, the Secretary of State may appoint one or more persons to fill the vacancy.[495]

Germany: in Germany, the GMS appoints the accountant (§ 119 AktG and § 318 HGB, see also sec. 7.2 GCGC).

Netherlands: In the Netherlands, the GMS appoints the external auditor, unless other ways are provided (art. 2:393 (2) NCC and Best Practise V.2 DCGC). However the SB shall nominate a candidate for this appointment, while both the audit committee and the BoM advise the SB (Best Practise V.2 DCGC).[496] According to Best Practise V.2.1 DCGC the external auditor may be questioned by the general meeting in relation to his report on the fairness of the financial statements. The external auditor shall attend for this purpose and be entitled to address this meeting. This entails a somewhat confusing concept now the BoM and (the audit committee of) the SB remain responsible for drawing up, structuring and the content of the annual accounts/report. This rule tends to make the external auditor an 'organ' of the enterprise.[497]

Thus in the examined EU countries, the GMS in general appoints the external auditor. In the US, the audit committee as a committee of the board takes up this responsibility. This seems to fit in the US system where the issuer is ultimately responsible for drawing up the annual accounts and report and to disclose these documents to the market and investors.

3.3.8 Fundamental changes of the issuers' charter or nature

If the company's fundamentals are to be changed, the GMS must usually give its consent. Corporate law reserves a handful of rules for this kind of decision. No jurisdiction, for example, authorises the board of directors to unilaterally amend the company's charter in a material way.[498] Corporate law limits board authority to make certain important transactions and decisions as altering the articles of incorporation/bylaws or total sale of assets. However the examined jurisdictions differ in the thresholds for effectuating certain significant corporate actions.[499] These differences for allowing fundamental changes, inter alia, seemingly reflect the different level of supremacy of the board.[500]

495 Gower and Davies, 2008, p. 775, however the proposal to appoint the auditors, to reappoint them or to appoint others in their place comes normally from the board and the meeting, almost invariably, will agree with the board's proposal. This is an example of a situation where the shareholders' coordination problems make it difficult, though not impossible, for them to generate a proposal of their own. *PvdS*, This 'problem' is of course exacerbated when the board has the initiative to put an item on the agenda of the annual meeting.

496 Best Practise V.2 DCGC, The remuneration of the external auditor, and instructions to the external auditor to provide non audit services, shall be approved by the supervisory board on the recommendation of the audit committee and after consultation with the management board.

497 Raaijmakers, *Ondernemingsrecht, Pitlo/Raaijmakers,* Deventer: Kluwer 2006, p. 554.

498 Reinier R. Kraakman, Paul Davies, Henry Hansmann, Gerard Hertig, Klaus J. Hopt, Hideki Kanda & Edward B. Rock, *The Anatomy of Corporate Law, A Comparative and Functional Approach*, New York: Oxford University Press 2004, p. 131.

499 Cf. Reinier R. Kraakman, Paul Davies, Henry Hansmann, Gerard Hertig, Klaus J. Hopt, Hideki Kanda & Edward B. Rock, *The Anatomy of Corporate Law, A Comparative and Functional Approach*, New York: Oxford University Press 2004, p. 132, there is, however, an important complication. Because jurisdictions weigh the interests of shareholders, minority shareholders, and stakeholders differently, they inevitably diverge to some extent in how they select and regulate 'significant' corporate decisions.

500 Cf. Reinier R. Kraakman, Paul Davies, Henry Hansmann, Gerard Hertig, Klaus J. Hopt, Hideki Kanda & Edward B. Rock, *The Anatomy of Corporate Law, A Comparative and Functional Approach*, New York:

3.3.8.1 *Substantial change of corporate governance structure: amendments to the articles of association/bylaws/corporate governance codes*

In comparing the authority of the GMS to alter the charter, a distinction has first to be made between the memorandum/articles of incorporation and the articles/bylaws. In the US, the articles of incorporation set out the corporation's essential rules, the basic terms under which it will operate.[501] The UK memorandum (articles of incorporation) only requires entering the names of the founders and first shareholders in the document (sec. 8 UK CA 2006). The US and UK (secs.18 and 21 UK CA 2006) articles (bylaws[502]) regulate the internal organisation of the company. In the UK, the principle is that the articles may regulate any subject not regulated in any other source of UK company law.[503] The UK model articles for public companies limited by shares as promulgated by the Secretary of State provide a default system; these model articles will apply, unless different or amended articles are chosen.[504]In the UK, substantive matters relating to the central operation of the company are largely left to regulation by the articles. Thus, matters of internal organisation, such as the division of powers between shareholders and the board, are mainly regulated by these articles. However, the UK CC also has an influence on the above-mentioned autonomy of the company.[505] In Germany and the Netherlands, such a distinction between the articles of incorporation and bylaws is not made, in both systems, and especially in Germany, the internal organisation mainly follows the statutory rules on the division of powers between shareholders and the board as inserted into the articles of incorporation. § 23 (5) AktG provides that the company charter may deviate from the provisions of the law only where expressly provided for in the law, and such express grants are not generously provided.[506]

Oxford University Press 2004, p. 131, although the efficiencies of the corporate form require centralizing management power, shareholders need not (and generally do not) delegate all authority to act for the corporation to the board of directors. Even a board-centered jurisdiction such as Delware must grapple with the problem of optimal delegation, that is, of just how much discretion to delegate to the board.

501 Once the articles are filed with the appropriate authority (US Secretary of State's office, UK Registrar) the company comes into existence.

502 The US bylaws are decided upon the first organisational meeting of the board and provide mainly the internal roadmap for the corporation. Stephen M. Bainbridge, *Corporate law and Economics (2*nd *edition)*, Foundation Press 2009, p. 15, the bylaws typically deal with such matters as number and qualification of directors, board vacancies, board committees, quorum and notice requirement for shareholders and board meetings, any special voting procedures, any limits on the transferability of shares, and titles and duties of the corporation's officers.

503 Gower and Davies, Principles of Modern Company Law, Sweet & Maxwell, London: 2008, p. 62.

504 Former model articles are: Table A of 1985 or earlier of 1948. Now applying model articles are for public companies Schedule 3 to the draft Regulations. Gower and Davies, Principles of Modern Company Law, Sweet & Maxwell, London: 2008, p. 67, the company's articles become a public document at the moment of formation, either because the relevant model articles, themselves a public document, will apply or because the company supplies to the registrar for public registration its own articles which amend or even fully replace the statutory model.

505 Gower and Davies, Principles of Modern Company Law, Sweet & Maxwell, London: 2008, p. 62.

506 See D. Donald, 'Approaching Comparative Company Law', *Institute for Law and Finance (ILF) Working paper series no. 77,* 12 February 2008, p. 46, the AktG is also quite inflexible, and leaves little room for individualized company structures. § 23 (5) AktG provides that the company charter may deviate from the provisions of the law only where expressly provided for in the law, and such express grants are not generously provided. As Prof. Karsten Schmidt notes, pursuant to German corporate law, 'the constitution-like, prescribed structure of the stock corporation may be altered only slightly by the articles of incorporation, given that, contrary to limited liability companies and partnerships, the

In Germany, the GGCG also mainly sticks to this statutory division of powers as provided by the AktG. The DCGC imposes some rules beyond statutory law and, combined with its enforcement, has seemingly eroded the supremacy of the Netherlands public corporation (listed). Chapter 4 will elaborate on this presumption.
The US system provides a default system of company law in which shareholders, according to their own preferences, can adopt the rules as provided by the articles and bylaws.[507] However, the possibility to alter the constitution, after the initial articles of incorporation are filed with the Secretary of State's office and the bylaws are adopted by the incorporator or the initial director's at the corporation's organisational meeting of the corporation,[508] is restricted in two respects, 1) only on initiative of the board can the articles be changed (§ 242 (b) (1) DGCL), if the board makes a proposal amendments to the articles must be approved by a majority of shares eligible to vote (§ 242 (b) (1) DGCL); § 10.03 (e) MBCA only requires a majority vote: an amendment is approved if more shares are voted affirmatively than voted negatively,[509] 2) the bylaws can be amended not only by the shareholders but also by the board (§ 10.20 MBCA).[510] To forestall cycling amendments and counter-amendments § 10.20 (b) (2) MBCA authorises the board to adopt, amend and repeal bylaws unless "the shareholders in amending, repealing, or adopting a bylaw expressly provide that the board of directors may not amend, repeal, or reinstate that bylaw". § 109 (a) DGCL provides that only shareholders have the power to amend bylaws, unless the articles of incorporation expressly confer that power on the board of directors. Delaware incorporated articles of incorporation often determine that the board has the aforementioned authority.[511] § 109 (a) DGCL ends by stating that this shall not divest the stockholders or members of this power, nor limit their power to adopt, amend or repeal bylaws. These broad powers for shareholders to alter the bylaws are limited by § 109 (b) DGCL: the bylaws may contain any provision, not inconsistent with law or with the certificate of incorporation, relating to the business of the corporation, the conduct of its affairs, and its rights or powers or the rights or powers of its stockholders, directors, officers or employees (cf. § 206 (b) MBCA). § 109 DGCL results in an internal tension in the Delaware corporate law statute between the clear principle of board authority and the power of the shareholders to alter the bylaws; attempts by stockholders to adopt bylaws limiting or influencing director authority inevitably offend the notion of management by the board of directors.[512] In *CA, Inc. v. AFSCME Employees Pen-*

stock corporation is governed by the principle that the form of constitutional documents is strictly prescribed, see also Karsten Schmidt, *Gesellschaftsrecht*, Heymans 2002, p. 771.

507 Gower and Davies, Principles of Modern Company Law, Sweet & Maxwell, London: 2008, p. 63. In substance related to the division of powers, it is said the US system results in similar system as in the UK. However a particular difference is that in the UK the board derives its powers delegated by the shareholders through the articles of incorporation; in the US and also in Germany this power is derived from the statute. In control situations in the UK shareholders seem withdraw their delegated powers.

508 § 109 (a) DGCL, and after a corporation has received any payment for any of its stock.

509 Stephen M. Bainbridge, *Corporate law and Economics (2*nd *edition)*, Foundation Press 2009, p. 14.

510 Cf. Mathias M. Siems, *Convergence in Shareholder Law*, New York: Cambridge University Press, 2008, p. 162.

511 1-9 Delaware Corporation Law and Practice § 9.02

512 See Delaware Chancery Court in General *DataComm Industries, Inc. v. State of Winconsin Investment Board*, 731 A 2d 818, 821 n. 2 (Del. Ch. 1999).

sion Plan[513] the Delaware Supreme Court affirmed the supremacy of the board: only the board of directors is empowered to manage the corporation's business and affairs, not the corporation's shareholders. The bylaws may not "mandate how the board should decide specific substantive decisions", but may "define the process and procedures by which those decisions are made". However, the precise relationship (substance/procedure) between §§ 109 and 141 DGCL remains subject to future case-by-case analysis.[514] Stephen Bainbridge argues that bylaws should be treated the same way as articles of incorporation or, for that matter, virtually every other corporate action. He states: "The shareholder power to initiate bylaw amendments without prior board action is unique. It is also an historical anachronism states unthinkingly codified from old common law principles lacking either rhyme or reason. There simply is no good reason to treat bylaws differently than articles of incorporation".[515] Bebchuk argues to the contrary and states that shareholders should be allowed to initiate not only bylaw provisions but also charter provisions (rules-of-the-game decisions). However, under Delaware law, shareholders' initiative to alter the corporation's constitution is still inconceivable, even if their authority to alter the bylaws is taken into account.

EU: At EU level, no new proposals have been published with respect to changes of the internal organisation as provided for in the memorandum of incorporation or articles of incorporation since the draft 5th Directive was withdrawn (2004). Art. 39 (1) draft 5th Dir. required a majority of no less than two thirds of votes carried by shares represented at the meeting or of the capital subscribed which is represented at the meeting for passing resolutions altering the statutes.[516] Concerning corporate governance, an EU CGC did not emerge. However, companies incorporated within the European Economic Area (EEA) and whose securities are traded on a regulated market have to make full disclosure about compliance ("comply or explain" rule) with their national code as a result of art. 46A of the 4th EU Directive on accounts.[517] When a company deviates from the principles and rules of the applicable national code, it has to explain its reasons for doing so. Apart from market pressure for

513 453 A 2d 227 (Del. 2008). See Stephen M. Bainbridge, *Corporate law and Economics (2nd edition)*, Foundation Press 2009, p. 18.

514 See Stephen M. Bainbridge, *Corporate law and Economics (2nd edition)*, Foundation Press 2009, p. 18, as for the conflict between §§ 109 and 141, the court stated that: "Because the board's managerial authority under § 141 (a) is a cardinal precept of the DGCL, we do not construe § 109 as an 'exception…otherwise specified in the DGCL to § 141 (a). Rather, the shareholders' statutory power to adopt, amend or repeal bylaws under § 109 cannot be 'inconsistent with the law', including § 141 (a)." Cf. also Cf. Mathias M. Siems, *Convergence in Shareholder Law*, New York: Cambridge University Press, 2008, p. 162, it is disputed whether and to what extend the articles of incorporation can shape or restrict this dualism, and whether the board can reverse a decision of the general meeting. The question of the place of the by-laws is of topical interest particularly in takeovers. Shareholders seek to use by-laws to limit management's room for manoeuvre. How far this is permissible has not yet been conclusively clarified. See however Delaware Chancery Court in General *DataComm Industries, Inc. v. State of Winconsin Investment Board*, 731 A 2d 818, 821 n. 2 (Del. Ch. 1999).

515 See Stephen M. Bainbridge, *Corporate law and Economics (2nd edition)*, Foundation Press 2009, p. 18.

516 See also art. 39 (2) 5th Dir., where the laws of the MS provide that the GMS may validly transact business only if at least one half of the capital subscribed is represented, resolutions for alteration of the statutes shall require a majority not less than that required under art. 36 (1), Resolutions of the GMS shall be passed by absolute majority of votes cast by all the shareholders present or represented, unless a greater majority or other requirements be prescribed.

517 Inserted in that Directive by art. 1(7) of Directive 2006/46/EC.

compliance, EU law does not provide for any formal GMS involvement/vote to be required for a change in its corporate governance structure.

UK: In the UK, the articles can only be altered by the GMS by a special resolution requiring a majority of 3/4 of the votes (secs. 21 and 283 UK CA 2006)[518]. The memorandum or articles of association may not eliminate or limit the power to change these basic documents by special resolution.[519] The UK Listing Rules (LR) require UK-registered companies with a primary listing in the UK to disclose in their annual report the extent to which they have complied with the UK CC and to give reasons for areas of non-compliance.[520] The sanctions for non-compliance with the LR are severe, but it would be perfectly in compliance with the LR for the company to report that it has not complied with the CC in any respect on the condition it also gives an explanation for this. Apart from market pressure for compliance, no formal GMS involvement/vote is required for a change in its corporate governancestructure.

Germany: In Germany, the GMS is allowed by a majority vote of 75% or higher, as set by the articles (§ 179 (2) AktG) to amend the articles of incorporation (§§ 119 (1) nr. 5 and 179 (1) AktG). In general, delegating this power to another organ of the company is not allowed. However, in case of a BoM decision to reduce the capital by repurchasing their own shares or to raise new capital (§ 202 AktG) the BoM can be authorised to alter the articles of incorporation as a consequence of the aforementioned decisions (§ 179 (1) AktG).[521] § 161 AktG requires listed companies to state publicly whether and to what extent they comply with the code. Compare also sec. 3.10 GCGC, which states that the MB and SB shall report each year on the enterprise's corporate governance in the annual report (corporate governance report). This includes the explanation of possible deviations from the recommendations of this Code. Apart from market pressure for compliance, no formal GMS involvement/vote is required for a change in its corporate governance structure.

Netherlands: According to art. 2: 121 (1) NCC, a GMS has the authority to alter the articles of incorporation.[522] As far as the authority to alter the articles of incorporation has been excluded, alteration of these articles is still possible with a unanimous vote with a quorum of the outstanding capital. When an article stipulates that one or more articles only can be

518 However the principle that constitution of the company can be altered by a three-quarters majority of the members can be in fact set aside by using entrenchment provisions; Sec. 22 UK CA 2006 enables the shareholders to make provisions capable of amendment or repeal only if certain conditions or procedures are met. Therefore, amendment or repeal could be made conditional the consent of a particular member or a higher percentage of the members than a special resolution requires. Entrenched status can be conferred upon provisions in the articles either upon the formation of the company. This mechanism of entrenchment almost functions the same as e.g. the use of priority rights.

519 See *Malleson v. Nat'l Ins. & Guar. Corp.*, [1894] 1 Ch. 200 (1893).

520 LR 9.8.6 (5), cf. also LR 9.8.7., a company not incorporated in the UK but with a primary listing in the UK must explain whether it complies with the corporate governance code of its country of incorporation and how that code differs from the CC, but is not required to explain areas of non-compliance. Cf. Gower and Davies, 2008, p. 404.

521 Cf. A.G.H. Klaassen, *Bevoegdheden van de algemene vergadering van aandeelhouders, Historische, concernrechtelijke en rechtsvergelijkende beschouwingen, in het bijzonder over structuurwijzigingen*, Deventer: Kluwer 2007, p. 81.

522 See amongst others J.J.M. Maeijer, *Asser 2-III Vertegenwoordiging en Rechtspersoon, De Naamloze en de Besloten Vennootschap*, Deventer: Tjeenk Willink 2000, nr. 540, E.J.J. van der Heijden and W.C.L. van der Grinten, *Handboek voor de Naamloze en de Besloten vennootschap* (11th edn.), W.E.J. Tjeenk Willink, 1989, No. 342, P. Schilfgaarde en J. Winter, Van de BV en de NV, Kluwer: Deventer 2009, No. 124.

altered under certain conditions, then this article itself can only be altered under the same conditions (art. 2:121 (2) NCC) or when an article stipulates that one or more articles cannot be changed, this article itself can only be altered with a unanimous vote with a quorum of the outstanding capital. Art. 2:391 sub 5 NCC provides a legal ground for the application, on a comply or explain basis, of the DCGC. Best Practise I.2 DCGC further requires every substantial change in the governance structure of the corporation and adherence to the DCGC to be submitted for discussion to the GMS under a separate agenda item. This provision in a certain way tends to give these corporate governance principles and best practices the gloss of having the same status as the company's articles of incorporation (bylaws). As will be discussed in chapter 4 this has been made possible by extensive explanation of the DCGC by the Enterpise Chamber under the umbrella of art. 2:8 NCC (reasonableness and fairness).[523]

Thus in the UK, Germany and the Netherlands, the GMS has the authority to amend the articles of incorporation. Compared to the other systems, the UK system of default model articles offers shareholders the most discretion in altering the articles of incorporation to suit their own preferences. Notably, the UK CA 2006 allows for entrenched articles, which allows for founders of the company to be provided with a priority share, for example. Also the German and Dutch systems allow for (some) articles not to be changed, however the GMS, under higher thresholds, always reserves the authority to alter these articles. Especially in Germany shareholders have less room for altering the articles according to their own preferences because the AktG entails a mandatory system for the companies' constitution and the division of powers between the board and the GMS. The GCGC also mainly follows this statutory model.[524] The NCC provides also a mandatory system (see art. 2:25 NCC[525]) for the company's constitution, but with more room for deviation in the articles, especially when a company does not have to adhere to the "structuurregime" for 'large' companies. However, an important difference with the other systems is the application of the DCGC. This corporate governance code in some respects goes further than statutory law. As with most other European corporate governance codes, it has to be applied on a comply or explain basis.[526] However, as will be elaborated further in chapter 4, combined with the Dutch enforcement mechanism of the Amsterdam Enterprise Chamber ("enqueterecht"), the principles and best practise of the DCGC have been held by the court to be to 'enforceable' a certain extent. Compared to the US and UK systems, these DCGC principles and best practices therefore tend to be regarded as "mandatory" model articles for a public corporation/mandatory bylaws. If and how this Dutch system of application and enforcement of the DCGC contributed to an erosion of the supremacy of the board of a Netherlands public corporation will be explained in chapeter 4. Another important difference with the US is, however, that the US board has a privileged position with respect to the initiative for altering the corporation's constitution; only the co-authority with respect to altering the

523 That provision in a certain way, i.e. in as far as adherence can be pressed for by the GMS, tends towards a sort of bylaws since the power whether or not to adhere rests with the MB and SB.

524 Cf. H.H. Voogsgeerd, *Markt- of rechtsarrangement?*, Deventer: Kluwer 2006, p. 11.

525 Art. 2:25 NCC, the articles of Book 2 ("legal entities") provide mandatory law, unless the articles itself leave room for deviation.

526 Cf. Eddy Wymeersch, 'Enforcement of Corporate Governance Codes', *ECGI-Law Working Paper No. 46*, 2005.

bylaws gives the shareholders a limited power to influence the corporation's constitution. However this shareholder power only confers to procedural rules how substantive board decisions are (should be) made.

3.3.8.2 Important changes of identity or character of the corporation and major transactions
In most countries for the transfer of the whole or substantial company assets the GMS must consent.[527] There are, however, considerable differences between the examined jurisdictions.
In the US, the BoD has essentially unconstrained authority to sell, lease, mortgage or otherwise dispose of corporate assets, except for the disposal of all or substantially all corporate assets. These kind of transactions shall be approved by the shareholders,[528] § 271 (a) DGCL: shareholders are entitled to vote on 'sales, leases or exchanges of all or substantially all of the corporation's property and assets'. The definition of 'substantially all' has been developed in case law, see for example *Katz v. Bregman*, 431 A2d 1274 (Del Ch. 1981);[529] in general disposal of 75% of the total assets requires consent of the shareholders.[530] Compare also § 12.02 MBCA,[531] which requires approval of the shareholders if the disposition would leave the corporation without significant ongoing business activity (< 25 % of total assets). This

527 Cf. Allen, Kraakman and Subramanian, *Commentaries and Cases on the Law of Business Organization(2*nd *Edition)*, New York: Aspen Publishers 2007, p. 461, they suggest that, rationally, principals will reserve power to veto those matters that are most economically significant and in which they have some capacity to exercise informed judgment. In the corporate context, these criteria suggest that dispersed shareholders will wish to decide at most only very large issues (those that affect their entire investment) and will wish to decide only issues that they can be expected to decide with some competence ("investment-like" decisions rather than "business" decisions). However, also in this case the question is whether shareholders have that ability and information to make this kind of decisions.

528 § 271 (a) DGCL, shareholders are entitled to vote on 'sales, leases or exchanges of all or substantially all of the corporation's property and assets.

529 Cf. also *Gimbel v. Signal Companies*, 316 A. 2d 599 (Del.Ch. 1974).

530 This however is not a clear line in *Katz v. Bregman* the court also took into consideration the nature of the transaction plus the fairly high percentage of the assets being sold, this satisfied the "all or substantially all" standard and shareholder therefore was required. Stephen M. Bainbridge, *Corporate law,* 2nd edition, 2009, p. 346, a well-known rule of thumb suggests assuming that a sale of more than 75% of balance sheet assets by market value is a sale of substantially all corporate assets and that a sale of less than 25% is not. Between those yard lines, one must make an educated guess based on qualitative considerations of the sort identified by Gimbel and Katz.

531 Cf. also the § 12.01 MBCA no approval of the shareholders of a corporation is required, unless the articles of incorporation otherwise provide: 1) to sell, lease, exchange, or otherwise dispose of any or all of the corporation's assets in the usual and regular course of business. The Official Comment states that shareholder approval is not required for a disposition of the corporation's assets in the usual and regular course of business, regardless of the size of the transaction. Examples of such dispositions would include the sale of a building that was the corporation's only major asset where the corporation was formed for the purpose of constructing and selling that building.

approval entails a majority vote of the shareholders entitled to vote. Other transactions, such as large share issues and asset purchases [532] do not require shareholder approval.[533]
In the UK, under the LR, significant transactions which meet the test of being "Class 1" transactions require shareholder approval; the LR nr. 10 'Class 1-tranctions', "Class 1" criteria are met if the transaction in question involves assets being acquired, the profits attributable to the business being acquired, the consideration being paid under the transaction or the capital of a company being acquired exceeding one quarter of the company's existing assets, profits or capital, as the case may be.[534] As will be explained in chapter 4, the nature of the LR's enforcement seemingly has a different result on the supremacy of the board.
In Germany, in the event of the transfer of all the company's assets, § 179 (a) AktG requires a decision of the GMS similar to that for alteration of the articles of incorporation (§ 179 (1) AktG): a majority vote of 75%[535]. Nevertheless, in Germany, case law for de facto changes to the company uses § 119 (1) AktG starting point.[536] In the Gelatine-case,[537] not rejecting but confirming the famous *Holzmüller* case, the German Supreme Court rejected a low threshold of 20-25% requiring involvement of the GMS: in order not to needlessly disrupt the balanced relationship of the company's bodies, the involvement of the GMS on the ground of a major impairment of the unwritten participatory rights of shareholders would come into question only in *exceptional cases.*[538] The 'threshold of seriousness' would accordingly as a

532 Allen, Kraakman and Subramanian, *Commentaries and Cases on the Law of Business Organization (2*nd *Edition)*, New York: Aspen Publishers 2007, p. 462, the different treatment of the sale of substantially all assets of a corporation and as well a shareholder vote on a merger, compared to a purchase of assets that transforms the business of a corporation, is explained by possible concerns of shareholders relating to shareholder future control over managers, rather than size or shareholder competence. The former reason is a determent of when the law requires a shareholder vote. The other examined jurisdictions seemingly draw a different line for determining for which corporate transactions a shareholder vote is necessary. Cf. e.g. art. 2:107a NCC which also relates to the size of a corporate transaction to require a shareholder vote.

533 Allen, Kraakman and Subramanian, *Commentaries and Cases on the Law of Business Organization (2*nd *Edition)*, New York: Aspen Publishers 2007, p. 461. However the NYSE Listing Rules do require companies to obtain shareholder approval if they issue 20 percent or more of their outstanding stock in a single transaction, NYSE Listed Co. Rule 312.03 (c).

534 LR 10, The FSA has the power to dispense from the application of this rule. Cf. Gower & Davies, 2008, p. 377, the thought behind the provisions seems to be that a big transaction is as much like an investment decision as a management decision and so the shareholders are to be involved in the taking of the decision, along with the management. This ground for insisting on shareholder involvement in a decision has no counterpart in the Act.

535 German case law has established that when a corporation is left without a significant (< 25 % of total assets) continuing business activity a GMS vote under § 179 (a) AktG is required. Compare this to § 12.02 MBCA.

536 Cf. Siems, *Convergence in Shareholder Law*, Cambridge University Press, 2008, p. 165. Cf however A.G.H. Klaassen, Bevoegdheden van de algemene vergadering van aandeelhouders, Historische, concernrechtelijke en rechtsvergelijkende beschouwingen, in het bijzonder over structuurwijzigingen, Deventer: Kluwer 2007, No. 60, p. 183, the BGH states that the approval right of the GMS in case of transactions resulting in a change of the identity or character of the company does not follow from § 119 (2) AktG it purely is a result derived from case law.

537 BGH, BGHZ 159, 30 (Gelatine).

538 Cf. BGHZ 159, 30 (44/45), '(..) eine im Gesetz nicht ausdrücklich vorgesehene Mitwirkung der Hauptversammlung bei Geschäftsführungsmaßnahmen des Vorstands nur in engen Grenzen, nämlich dann in Betracht kommen, wenn sie an die Kernkompetenz der Hauptversammlung, über die verfassung der Gesellschaft zu bestimmen, rühren und in ihren auswerkung einem zustnad nahezu entsprechen, der allein durch eine Satzungsänderng herbeigeführt werden kann.'

rule be reached only if a sale accounted for some 80% of company assets.[539] This percentage is derived from the *Holzmüller* case.[540]

Under Dutch law, a decision that results in an important change of the identity or character of the corporation has to be submitted according to art. 2:107a NCC for approval to the GMS. Subsequently, the article gives some specific board actions requiring the approval of the GMS. Art. 2:107a (1) (a) NCC[541] connects with the US and UK system in the case of a sale of all or almost all assets. In that case approval of the GMS is required. Art. 2:107 a (1) (b) NCC requires a GMS vote if the board decides to enter into or to dissolve a long-term cooperation of the firm with another legal entity, insofar this results in major consequences for the firm. Art. 2:107 a (1) (c) NCC relates to the size of a transaction and uses a threshold of one third to determine whether a GMS is needed; once the board takes a decision resulting in taking or disposing off an interest in the capital of a firm with a value of at least one third of the amount of the assets according to the balance sheet with explanation and according to the most recent annual account of the firm, by the company or a subsidiary. In the *ABNAMRO*-case,[542] art. 2:107a NCC was tested, the Netherlands Supreme Court held that the sale of ABNAMRO's subsidiary La Salle to the Bank of America did not require approval by the GMS. The Court held that the board has discretion to set the company's strategy and that the sale of LaSalle did not meet the thresholds of art. 2:107a NCC.

Moreover, Best Practise IV.1.3 DCGC requires the board to disclose a (non-public) offer *for a subsidiary* that exceeds the limit of art. 2:107a NCC. This rule was inspired by the *HBG* case (notably the decision by the Amsterdam Business Court was reversed by the Supreme Court). An equivalent rule does not exist in the US, UK or Germany, although it may be compared to the famous decision of the Bundesgerichtshof in the *Holzmüller* case (BGHZ 83, 122). However this case was confirmed by the *Gelatine* case and in short, only in exceptional cases is a shareholder vote necessary when a company decides to execute a significant transaction. Thus, compared to the other systems, especially the UK and the Netherlands, it provides a substantially lower threshold for the GMS to approve major transactions and transactions causing an important change of identity or character of the corporation. In the US and Germany, only in exceptional cases is GMS approval of a transaction needed. Apparently, the Dutch system, with the possibility to request an inquiry, has a profound influence. In the UK, the ultimate and severe sanction is delisting. Under the investigation procedure, a decision by the Chamber of Business put the LaSalle transaction on hold and thereby also slowed down ABNAMRO's decision to merge with Barclays. The Netherlands right of inquiry will be discussed in chapter 4.

539 BGH, BGHZ 159, 30 (Gelatine), Cf. Siems, *Convergence in Shareholder Law*, Cambridge University Press, 2008, p. 166. Cf. also A.G.H. Klaassen, Bevoegdheden van de algemene vergadering van aandeelhouders, Historische, concernrechtelijke en rechtsvergelijkende beschouwingen, in het bijzonder over structuurwijzigingen, Deventer: Kluwer 2007, No. 60, p. 183.

540 BGHZ 83, 122 (Holzmüller).

541 Before the introduction of this statutory requirement the doctrine already required approval of the GMS in this kind of transaction. Cf. Asser/Maeijer 2000, nr. 258.

542 Dutch Supreme Court 13 July 2007, *LJN* BA7970 (ABNAMRO).

3.3.9 Public tender offers

In case of a public tender offer, a possible conflict of interest may arise between the board (appointment in resulting entity; golden parachutes) and the shareholders (maximum premium).

In US law, neither the bidder's nor the target's shareholders have to approve a public offer. This may be different in certain specific transactions such as (legal) mergers and divisions.[543] In a public (hostile) tender offer, the bidder may bypass the target's board by directly addressing the target's shareholders without any action by the target's board being required. However, since the 1970s hostile tender offers were often resisted by defensive tactics developed to impede such offers. A number of US states adopted anti-takeover acts.[544] These developments reinforced the position of the target's board.[545] Constituency statutes, for example, allow the board to take into account the interests of other stakeholders in taking defensive measures without the consent of shareholders. That discretionary board power, however, is limited if its decisions are contaminated by the self-interest of the members, as evidenced by Delaware case law on the limitations on the business judgement rule for deciding when defensive measures of the board are allowed.[546] This will be further discussed in chapter 4.

The EU Transparency Directive[547] establishes, albeit optionally, a duty of neutrality in its art. 9 and restricts (art. 11) the use of transfer and voting restrictions in takeover bids ("breakthrough rule"). However, art. 12 (1) allows MS to exclude these provisions and thus retain the existing defensive possibilities. Thus, arts. 9-12 are optional; GMS action is not required. Neither does it require a GMS to discuss a definitive public offer.

In the UK, the City Code on Takeovers and Mergers provides a comprehensive framework of self-regulation for, inter alia, tender offers. This code now, in view of the formal implementation of the Takeover Directive, has a statutory basis: sec. 943 UK CA 2006. The City Code and the guidance of the Panel on Takeovers and Mergers is considered to be investor-friendly.[548] The board may not take any action that could effectively result in any bona fide offer being frustrated or in the shareholders being denied an opportunity to decide on its merits.[549]

543 See the annexes.
544 Lucian A. Bebchuk, Alma Cohen and Allen Ferrell, 'Does the Evidence Favour State Competition in Corporate Law?', 90 *California Law Review* Vol. 90, 2002.
545 Stephen M. Bainbridge, *Corporate law and Economics (2*nd *edition)*, Foundation Press 2009, p. 376.
546 See ch. 4: In case of a creeping hostile takeover the target board (US) has a gate-keeping function. Although taking protective measures (poison pill, sale of assets, transaction with a 'white knight') the target board cannot simply qualify as '*interested director transactions*' (§ 144 DGCL), the target's board members in that situation also simply qualify as independent, now they in case of a successful bid can loose their function. That is the reason the Delaware courts have adjusted the BJR if investors claim that the target's board members have breached their fiduciary duties in defending the corporation against a hostile takeover. It moves between two extremes: a) the assumption by the BJR that they are disinterested/independent, and b) that that assumption has been disproved and the target board members have to abstain of any action that could interfere with that takeover.
547 Directive 2004/25/EC.
548 John Armour and David A. Skeel, 'Who Writes the Rules for Hostile Takeovers, and Why? The Peculiar Divergences of US and UK Takeover Regulation', *ECGI Law Working Paper No. 73,* 2006.
549 General Principle 3 and Rule 21 UK City Code. Cf. Mathias M. Siems, *Convergence in Shareholder Law*, New York: Cambridge University Press, 2008, p. 183.

German takeover law provides that, after the filing of a takeover bid, management must take the interests of the target company into account, Wertpapiererwerbs- und Übernahmegesetz (§ 3(3) WpÜG). This 'interest of the firm' entails a stakeholder concept embracing the interests of shareholders and of employees.[550] This approaches the function of the US anti-takeover statutes, as will be discussed in chapter 4. The WpÜG does not oblige the board to take into account a strict rule of neutrality. The BoM is not bound by the bar on measures to obstruct a takeover (§ 33 (1) WpÜG (s.1)), if it is so authorised by the SB or the GMS, or the measures taken are part of everyday conduct of business or are part of the search for a competing bid (§ 33 (1) (s.2), (2)) WpÜG)[551]. Under § 33a WpÜG, it is also possible for German companies to opt for a strict duty of neutrality.

In the Netherlands, the neutrality and breakthrough rules have not been implemented in (art. 2:359b NCC) as mandatory provisions, but as an option for issuers. Particular, recent decisions of the Enterprise Chamber and the Supreme Court regarding the listed public corporations RNA, Stork, ABNAMRO and ASMI offer some guidance in answering the question as to which norms apply in case of hostile takeovers.[552] The norms following from the Supreme Court decision in RNA can still be used as starting point for the target board's duties in case of a hostile takeover. In short: the corporation in principle may take protective measures to prevent a shareholder from acquiring control of paramount importance of the corporation. However, measure(s) taken in the given circumstances must be, on reasonable reflection of the interests at play, within the margins of an adequate and proportional reaction. This not only applies for taking these measures, but also in maintaining these protective devices. What in a specific case is adequate and proportional cannot be derived from the *RNA* decision.[553]

Dutch law also requires a meeting of shareholders to be called to discuss an offer for the issuer's share as well as the reaction from the board of the offeree (art. 18 Decree on Public Offerings). Neither German nor UK law require such a general meeting (§ 16 WpÜG). Compare Rule 24-27 City Code).[554]

3.3.10 GMS-powers re capital and shares

Unlike US law, EU and MS law reflects the principle of 'capital protection' and hence requires a series of corporate actions to be submitted for approval to the GMS (including pay outs). At EU level the 2nd, 3rd and 6th Directives provide for such rules. These are reflected in MS law.

550 Cf. Mathias M. Siems, *Convergence in Shareholder Law*, New York: Cambridge University Press, 2008, p. 185.

551 Mathias M. Siems, *Convergence in Shareholder Law*, New York: Cambridge University Press, 2008, p. 185.

552 M.J. van Ginneken, Vijandige overnames, De rol van de vennootschapsleiding in Nederland en de Verenigde Staten, Kluwer: 2010, p. 40 for an extensive analysis of the Netherlands rules in hostile takeovers.

553 Supreme Court 18 April 2003, *NJ* 2003, 286, with reference Maeijer, *JOR* 2003/110 with reference Blanco Fernandez (*RNA/Westfield)*; See also G.N.H. Kemperink, 'Enquêterecht en overname geschillen', *Ondernemingsrecht* 2002-8, p. 236-243; RNA en de ontwikkeling van het Nederlandse fusie- en overnamerecht, Stichting & Vereniging 2002-6, p. 155-162; M.J.G.C. Raaijmakers, 'Gedragsnormen voor overnamegevechten', *Tijdschrift voor Stichting, Vereniging & Vennootschap* 2003-6, p. 215-223.

554 A Reverse Takeover has presentes as a 'Class-1 Transaction' to the GMS (Listing Rule 10-6).

The US picture is different, the primary competence lies with the board; the board will decide whether to issue new shares or to repurchase own shares. Nonetheless, the GMS will be involved when the articles of incorporation have to be amended because of the share issue (see § 3.3.9.1) and the NYSE Listing Rules require companies to obtain shareholder approval if they issue 20% or more of their outstanding stock in a single transaction, NYSE Listed Co. Rule 312.03 (c).

In the Netherlands, the GMS has the power to issue shares, but may delegate that power to the BoM/SB (art. 2:96 a NCC),[555] whereas in the UK and the US (secs. 549, 551 and 569 UK CA 2006 ff, § 6.21 MBCA and § 152 DGCL, only the board has this authority) the board has the power to issue shares, and has the option to delegate this power to shareholders through the charter.

Similarly, the GMS shall decide on buy-back, but may delegate that power (art. 2:98 NCC);[556] in the US the board is empowered to do so (§ 6.31 MBCA and § 151 DGCL). Surpassing pre-emptive rights in the case of a share issue require GMS approval, again with power to delegate that power. Compare sec. 569ff UK CA 2006, and the US, § 6.30 MBCA, DGCL (no pre-emptive rights unless provided for in the issuers' charter).

The Dutch GMS approves the reduction of capital (arts. 2:99/100 NCC) (compare the US insolvency test in § 6.30 MBCA), amendments of articles of incorporation (art. 2:121 NCC, § 21 UK CA 2006, § 242 DGCL, only on initiative of the board, see also for alteration of bylaws § 242, 102 and 109b), conversion (art. 2:18/71 NCC), legal merger (arts. 2:317/330/331 NCC, § 251 DGCL and majority vote by shareholders of each constituent corporation, §§ 11.03 (a) and 11.04 (b), shareholder approval by each constituent corporation, legal split (art. 2: 334 NCC and § 107 MBCA and §§ 213 DGCL and 275 DGCL. After resolution of the board, majority vote shareholders, § 14.02 MBCA, after recommendation board, approval shareholders, order to apply for bankruptcy (art. 2:136 NCC) and delegation to fix record date (art. 2:119 NCC, see § 107 RMBCA and § 213 DGCL Changes of class rights attached to shares, § 630 UK CA 2006.

3.3.11 Conclusions

The previous paragraphs showed that the basic differences between the US and the EU can *prima facie* be illustrated by comparing shareholders' rights as attributed by the US MBCA and DGCL with the accumulated provisions of EU corporate law directives and national provisions. The MBCA and DGCL limit the (collective and individual) powers of 'shareholders' (remarkably and in contrast to the EU and MS *not* using the GMS as notion of a body corporate) to a few major issues: appointment and dismissal of board members, mergers and consolidations, sales, leases or exchanges of all or substantially all of the corporation's property. EU and (examined) MS corporate law provides for a far more extensive list: e.g. appointment, dismissal and remuneration of directors, adoption of the annual accounts and distribution of dividends from profit, discharge, appointment and assignment of external auditors, changes in capital and share issues, buy-back of shares, passing pre-emptive

555 § 6.21 MBCA power to issue shares lies with the board, but can be delegated in the charter to the shareholders; § 152 DGCL, issue of shares only the authority of the board.

556 § 6.31 MBCA, power of the board § 151 DGCL.

rights, legal merger, de-merger, dissolution, and change of substance and character of the firm, use of certain anti-takeover devices (grant options on preferred protective shares). Similarly provisions on boards, indemnification and insurance of its members, corporate reorganisations, exit rules (squeeze out, sell out and appraisal rights) reveal remarkable differences. Also in their substance shareholders' rights differ, for example UK and Dutch law provide for lower threshold for requiring GMS approval in the case of fundamental changes to the issuer's charter or nature. In comparison with the other systems, the position of the GMS in the organisational model of the Dutch listed public corporation has been amplified by extension of statutory shareholders' rights, but also by the DCGC that merely functions as quasi-bylaws and sometimes goes beyond statutory law. The Dutch system provides some peculiar GMS rights, such as: adoption of the annual account and separate discharge of the board; separately discharge of the SB is required. Thus, adoption of the accounts and determination of payable profits (dividends) can also take place without discharge. Consequently, the nature of the discharge seems to change to a 'poll' on present and future strategy and policies, thus extending the powers of shareholders in meeting and diminishing protection of board members. This departs from the other examined systems: in the US where the directors' right to statutory indemnification and the protection of the BJR in a derivative suit shields them from liability, in the UK where the court has to allow a derivative suit and in Germany where a new BJR. has been introduced.As will be explained in chapter 4, the function of the right of inquiry in combination with the strengthened position of the GMS in the organisational design of the Dutch public corporation has a profound influence on the supremacy and discretion of the board.

3.4 Group and individual rights of shareholders

Public corporations typically have a dispersed ownership base. Whether and to what extent individual or groups of investors can enforce their collective powers 'in meeting', i.e. as a body corporate, as discussed in the preceding paragraphs, will depend not only on the charter's quorum and majority requirements, but also on individual and group rights and powers to enforce the corporate charter and protect their rights regarding their capacity of investor-shareholder. To allow a full assessment, it is therefore necessary to review these statutory individual and group rights and powers. Individual rights evidently encompass voting rights, the right to receive dividends and distributions from a pay out by the issuer and residual rights upon dissolution. (Holders of certificates of shares or depository receipts usually are entitled to the same rights.)[557] These individual rights include those that are instrumental to enable collective exercise in meeting, such as the possibility to call an extraordinary meeting, to put items on the agenda of the meeting, and combine voting power through proxy solicitation. These influence the division of power between the board and the actual shareholders.[558] Their influence is thus partly determined by such procedural

557 They also can vote in the general meeting, except in case of a hostile takeover attempt (2:118a (2) NCC).
558 Extension shareholder rights. See EU Directive in shareholder rights concerning: record date, proxy voting, electronic voting, no solution for ultimate holder problems. Cf. also J. W. Winter, *Grensoverschrijdend stemmen*, Erasmus Universiteit Rotterdam: Oration 2000.

rules as convening a meeting and setting its agenda. The impact is clear: whether and to what extent the board/BoM may refuse to put an item on the GMS agenda is important in assessing the issuer's exposure to shareholder activism. The same is true for 'rules' on the 'dialogue' that issuers should pursue with their (major) (institutional) investor base. Particularly in case of disagreement, the power to enforce these rights determines their effective power, for example when one investor or a group wish to use the GMS's power to to challenge the incumbent management and thereby the supremacy of the board.[559]

The following paragraphs of this chapter aim at providing a comparative analysis of those group and individual rights of investors-shareholders that are functional or related to the internal division of powers that influence their position towards management and determine the balance of power between them. That means that other rights, such as a pre-emptive right of shareholders, will not be dealt with in detail. For these rights I refer to the inventory in the annexes. In par. 3.5 some general conclusions will be drawn.[560]

3.4.1 Right to call (special) meetings of shareholders

The examined systems require at least one general meeting *per annum* to be held. The power to call an (annual) general or special meeting is attributed to the board/BoM.[561] However, in the examined jurisdictions, shareholders can enforce that rule and force management to convene such a shareholder meeting, and, moreover, call a meeting themselves under some threshold, or apply for a court decree to call a meeting in case the board refuses to convene a meeting after a shareholder requisition notice.[562]

In the US, the Delaware statute requires that there be at least one shareholder meeting a year (§ 211(b) DGCL). However § 228 DGCL permits shareholders to act by written consent entailing at least a majority vote, seemingly illustrating that the GMS is not merely seen as a disciplining device by exercising voice (cf. also § 7.04 MBCA). In Delaware, the annual meeting of shareholders is mainly related to the election of directors. DGCL states in § 211(b) that unless directors are elected by written consent in lieu of an annual meeting, an annual meeting of stockholders shall be held for the election of directors on a date and at a time designated by or in the manner provided in the bylaws. A special meeting is held between annual meetings to consider extraordinary or urgent matters. [563] In Delaware (§ 211 (d) DGCL), a special meeting of stockholders may *only* be called by the board of directors or by such person or persons as may be authorised by the certificate of incorporation or the bylaws. This rule reflects the primacy of the board of the Delaware incorporated public

559 Cf. Gower and Davies, 2008, pp. 425 and 437, the detailed legal rules governing the holding and conduct of meetings of shareholders can also be significant if it comes to a public fight.

560 Before some general conclusion are drawn shareholders' rights to put items on the agenda will first be analysed since the right to put items on the agenda of the general meeting basically arises out of the rules of convocation; only a combining analysis with the agenda right can draw some preliminary conclusions as to difference in possibilities for shareholders to exercise these rights with the purpose to influence the companies' strategy and policy.

561 Mathias M. Siems, *Convergence in Shareholder Law*, New York: Cambridge University Press, 2008, p. 92.

562 Dirk A. Zetzsche, 'Shareholder Interaction Preceding Shareholder Meetings of Public Corporations. A six country comparison', *European Company and Financial Law Review*, Vol. 2, No. 1, CBC-RPS, no. 0003, 2005, p. 9.

563 Stephen M. Bainbridge, *Corporate law and Economics (2*nd *edition)*, Foundation Press 2009, p. 233.

corporation. § 7.02 (a) (1) MBCA also empowers the board of directors and any other person authorised by bylaws or articles to call special meeting, and § 7.02 (a) (2) MBCA empowers holders of at least 10% of the voting shares to call a special meeting on written demand to the corporation stating the purpose of the meeting.[564] However, in the US public corporation on these annual and special meetings many shareholders will in practice be physically absent, but vote by proxy. Federal *securities* law governs the procedure and disclosures requirements to solicit proxies.[565]

EU: the former art. 22 (1) 5th Dir. requires that the general meeting shall be convened at least once each year. This meeting may be convened at any time by the management organ (22 (2)). Art. 23 (1) 5th Dir. states that shareholders who satisfy the requirements of art. 16 (holding (a) shares of value *not* greater then 5%, (b) units not greater than 100,000), may request the company to convene a general meeting and settle the agenda therefore. If following this request no action has been taken by the company within one month, the competent court has power to convene the meeting or authorise it to be convened.

In the UK, every public company must hold its annual general meeting within the period of six months beginning on the day following its accounting reference date (sec. 336 (1) UK CA 2006), which determines the beginning and end of its financial year (sec. 391 UK CA 2006).[566] The board may convene a meeting of the members of a public company at any time (Sec. 302 UK CA 2006). Sec. 303 UK CA 2006 provides that the directors must convene a meeting on the request of holders of not less than one-tenth of the paid-up capital carrying voting rights. The request must state the general nature of the business to be dealt with at the meeting (sec 303 (4) UK CA 2006). It is advised to include the text of a resolution intended to be moved at the meeting.[567] It is important to note that the resolution must be one which may be 'properly moved' at the meeting and, if it is not, the directors are under no obligation to circulate it.[568] Sec. 303 (5) UK CA 2006: "a resolution may properly be moved at a meeting unless — (a) it would, if passed, be ineffective (whether by reason of inconsistency with any enactment or the company's constitution or otherwise), (b) it is defamatory of any person, or (c) it is frivolous or vexatious." If directors fail to call a meeting as provided for in sec. 303, sec. 305 UK CA 2006 allows the members who requested the meeting, or any of them representing more than one half of the total voting rights of all of them, to call a GMS themselves. Sec. 306 (1) UK CA 2006 also gives the court the power to convene a meeting.

Germany: § 121 (2) (1) AktG states that the GMS will be convened by the BoM. Furthermore, the SB is authorised to convene a general meeting if the interest ('Wohl') of the company demands such a meeting (§ 111 (3) AktG). Shareholders owning 5% of the capital of the AG are entitled to call a meeting of shareholders (§ 122 AktG). They have to indicate and argue 'the purpose and the reasons for' convening their proposal for the agenda and why

564 §§ 7.05, 7.02 (d) MBCA subjects that may be considered at a special meeting should be described in the notice of meeting.

565 Stephen M. Bainbridge, *Corporate law and Economics (2*nd *edition)*, Foundation Press 2009, p. 233.

566 Gower and Davies 2008, p. 441.

567 Gower and Davies 2008, p. 443.

568 Gower and Davies 2008, p. 443. A resolution may properly be moved at a meeting unless (a) it would, if passed, be ineffective (whether by reason of inconsistency with any enactment or the company's constitution or otherwise), (b) it is defamatory of any person, or (c) it is frivolous or vexatious.

the proposed items can not be suspended until the next ordinary general meeting.[569] The shareholders are *not* allowed to call a meeting if this meeting is convened for the purpose of resolving matters concerning the management of the corporation, as such matters are only at their discretion if the management board so requires (§ 119 (2) AktG: "über fragen der geschäftsführung kann die hauptversammlung nur entscheiden, wenn der Vorstand es verlangt").[570] This reflects the supremacy of the German BoM/SB (public corporation) expressed in § 76 AktG, the mandatory statutory division of powers as provided by AktG (§ 119 AktG) and case law: *Holzmüller* and *Gelatine* case (discussed in par. 3.3.9.2[571]). Thus the limitation of the minority's right to call a meeting also applies to transactions that in view of their fundamental importance for the company entail an unwritten competence of the shareholders' meeting to resolve (Holzmüller and Gelatine Doctrine). The management board has to decide autonomously whether it wants to take such measure and if it requires the approval of the general meeting. As we have seen in *Gelatine* this only applies in exceptional cases. The general meeting cannot take the initiative in those cases.[572] Nonetheless, it is permissible to call a meeting to determine confidence ('Vertrauensentzug') in the board members (§ 84 (3) AktG) and resolve on management actions in the context of this agenda item. However, the restrictive Holzmüller-doctrine means that this is exceptional. The minority right to convene a general meeting should not be abused (compare this to arts. 2:8 NCC and 3:13 NCC). A minority of shareholders (5%) can be authorised by a court to call the general meeting § (122 (3) AktG).

In the Netherlands, art. 2:108 NCC requires that (1) a general meeting of shareholders will be held annually within *6 months* of the end of the financial year or (2) a shorter period when provided for in the articles. A general meeting will also be held under certain conditions in case of a major decrease in capital (2:108a NCC). The BoM and the SB are authorised to call a general meeting (2: 109, 2:114 NCC). This power can be transferred in the articles of incorporation to "other persons". Shareholders (art. 2:110 (1) NCC), representing at least 10% of the issued capital or such lesser amount as is provided for by the articles, may, on their

569 P.P.M. Gozbach, 'Shareholder democracy: an analysis of the regulatory framework in Germany', *TvOB* 2008, p. 160. *Hüffer* Kommentar zum Aktiengesetz § 122 note 4; *Semler* in: Münchener Handbuch des Gesellschaftsrechts, Part 4: Die Aktiengesellschaft,3. edition 2007, § 35 note 14. A detailed reasoning is not to be demanded. Also, the shareholders do not need to formulate the wording of the requested resolutions. However, if board elections, approvals to corporate agreements or amendments to the articles of association shall be resolved, then the wording of the proposed amendments have to be named, because such wording has to be made known with the agenda (§ 124 (2) (2) AktG).

570 P.P.M. Gozbach, 'Shareholder democracy: an analysis of the regulatory framework in Germany', *TvOB* 2008, p. 160.Cf. also *Ziemons,* in K. Schmidt/Lutter (eds.), Aktiengesetz Kommentar, 2008, § 122.

571 In case of de facto changes to the company § 119 (1) AktG is used as starting point. In the *Gelatine* case (BGH, BGHZ 159, 30), not rejecting but confirming the famous *Holzmüller* case, the German Supreme Court rejected a low threshold of 20-25% requiring involvement of the GMS: in order not to needlessly disrupt the balanced relationship of the company's bodies, the involvement of the GMS on the ground of a major impairment of the unwritten participatory rights of shareholders would come into question only in *exceptional cases*\. The 'threshold of seriousness' would accordingly as a rule be reached only if a sale accounted for some 80 per cent of company assets. This percentage is derived from the *Holzmüller* case.

572 P.P.M. Gozbach, 'Shareholder democracy: an analysis of the regulatory framework in Germany', *TvOB* 2008, p. 160. Cf. also *Werner* in: Großkommentar zum Aktiengesetz, 4th edn. 1992 et seq., § 122 note 27; *Semler* in: Münchener Handbuch des Gesellschaftsrechts, Part 4: Die Aktiengesellschaft, 3. edition 2007, § 35 note 16; see also OLG Frankfurt DB 2005, 1207.

application, be authorised by the interim provisions judge of the court to convene a general meeting. On condition that a previous request to the BoM/SB, in writing, stating the exact matters to be considered has been filed with the BoM/SB and neither BoM nor SB has taken necessary steps, a meeting could be held within six weeks of the request.[573]

3.4.2 Shareholder's right to put items on the agenda

Under the examined systems, the basic rule is that the board will set the agenda, although there are some differences related to the right of shareholders to put items on the agenda.[574] The level of influence of the shareholders in the company (board supremacy) is, besides the substantive rights of the shareholders, partly determined by procedural rules related to calling a meeting and setting the agenda for the annual and special meeting. Thus, for example, whether and under which criteria the board/BoM under its discretion has the right to refuse to put an item on the agenda as it proposed by the shareholders seemingly influences a company's vulnerability to shareholder activism.

In the US, shareholders do not have the right to put items on the agenda (nor a legal right to ask questions in meeting),[575] the board controls the agenda. However, US securities regulation related to the system of proxy solicitation and voting give certain rights to *shareholders* (seen from a shareholder's perspective) to set the corporation's agenda. Under the shareholder communication rule (SEC Rule 14a-7), any shareholder may collect proxies for matters to be resolved in the general meeting. To enable contact with other shareholders, management may at its discretion either send the shareholders a list of other shareholders or pass on his communication to the other shareholders. In either case the shareholder must bear the costs, which are considerable taking into account that these proxy rules

573 Art. 2:110 (1) NCC, The interim provisions judge shall disallow the application if it does not appear to him that the applicants have previously requested the management and the supervisory board in writing, stating the exact matters to be considered, to convene a general meeting and neither the management nor the supervisory board, which in this case have equal powers, has taken the necessary steps so that the general meeting could be held within six weeks after the request

574 Dirk A. Zetzsche, 'Shareholder Interaction Preceding Shareholder Meetings of Public Corporations. A six country comparison', *European Company and Financial Law Review*, Vol. 2, No. 1, CBC-RPS, no. 0003, 2005, p. 7, preparation and voting comprise six steps. First: unless shareholders themselves invoke the meeting, the board of directors and officers – in two-tier jurisdictions, the board of management and the supervisory board [herein "management"] – prepare the schedule, the meeting agenda, and the management's proxy circular. Second: management identifies the shareholders of the company. Third: management serves notice of the meeting, either by public announcement or through direct communication with the shareholders. Fourth: before or after the notice, shareholders are likely to communicate with management, or amongst themselves, and co-ordinate their actions with respect to the meeting. Fifth: shareholders register in order to attend the meeting, and finally: they vote.

575 The provision that gives shareholders the right to ask questions on agenda items which must be answered finds no similar specific requirement in US law. While it is common practice to have discussions of pending issues at shareholder meetings and allow shareholder questions at meetings of publicly traded corporations, if a company refused to do so it is unclear if that would violate the law in the US. But such behaviour would violate accepted norms of corporate behaviour and thus is unlikely. Nonetheless, shareholders can use their inspection rights under § 220 (b) DGCL, requiring a shareholder asserting inspections rights to make a written demand setting forth a "proper purpose" for the request.

mostly relate to public companies with dispersed shareholders.[576] Another option is that shareholders can oblige the corporation to include a shareholder proposal in the proxy statement,[577] SEC Rule 14a-8. That rule entitles shareholders to include certain proposals in the company's proxy materials. The board, however, can exclude the proposals from the proxy materials on several grounds; SEC Rule 14a-8 provides a number of specific grounds to permit corporations to exclude shareholder-requested matter from the corporation's proxy solicitation materials (management has to notify the SEC that the firm intends to exclude the proposal, SEC Rule 14a-8(j)).[578] Rule 14a-8(i) lists 13 grounds that permit firms to exclude proposals from the company's solicitation materials.[579] SEC Rule 14a-8 (i)(1) excludes, inter alia: approval of a proposal that would be improper under state law and (SEC Rule 14a-8 (i) (x)), resolutions on specific amounts of cash or stock dividends. The reason for *that* exclusion, but also in general, is a crystallisation of the more general principle that shareholders should not vote on issues that are beyond their powers, since directors, rather than shareholders, decide upon the distribution of dividends in the US. Under state law, all corporate powers shall be exercised by or under the authority of the board (§ 141 (a) DGCL). The same reasoning applies to the exclusion of a proposal (SEC Rule 14a-8 (i) (7)), relating to a matter of ordinary business. Matters of ordinary business are regarded as the province of the board under the design of the corporate form. Therefore these shareholder proposals are often made in 'precatory form'. As already mentioned, the board has discretion whether to disregard this kind of proposal;[580] the board's decision to do so is protected by the BJR.[581] Formerly this also applied to proposals relating to an election for membership to the company's board of directors (SEC Rule 14a-8 (i) (8)). However, the SEC proposed allowing shareholders to come with their own slate of directors (proposal SEC Rule 14a-11, 2003).[582]

576 Cf. Mathias M. Siems, *Convergence in Shareholder Law*, New York: Cambridge University Press, 2008, p. 94.

577 SEC Rule 14a-8; (SEA) 17 CFR 240.14a-8 (a): a shareholder proposal is your (shareholder) recommendation or requirement that the company and/or its board of directors take action, which you intend to present at a meeting of the company's shareholders.

578 First, shareholders proposals must satisfy certain formal criteria: they must state the identity of the shareholder (SEC Rule 14a-8 (b) (1), the number of proposals (SEC Rules 14a-8c), the length of the supporting statement (SEC Rule 14 a-8 (d)), and the subject matter of the proposal (SEC Rule 14a-8i).

579 In the Netherlands the GMS can only decide on topics that place on the meeting's agenda.

580 Bernard S. Black, Disclosure, Not Censorship: The Case for Proxy Reform, 17 J. Corp. L. 49 (1991-1992), p. 541 and Sofie Cools, 'The Real Difference in Corporate Law between the United States and Continental Europe: Distribution of Powers', *Delaware Journal of Corporate Law, Vol. 30, No. 3,* 2005.

581 Stephen M. Bainbridge, *Corporate law and Economics (2nd edition)*, Foundation Press 2009, p. 267, of course on the other hand, the risk of adverse publicity and poor shareholder relations may encourage a board to implement an approved precatory proposal even where the board opposes the proposal on the merits. (4) *Conflicts with company's proposal*: the proposal directly conflicts with one of the company's own proposals to be submitted to shareholders at the same meeting. The fourth reason relates to the fact that shareholders have the choice of voting "no" when voting upon the management's proposal. This exclusionary ground is, however, apt to impede the shareholders' franchise, since management can effectively pre-empt a pending or imminent shareholder proposal. This obstacle indicates the more general problem resulting from the discretion vested in U.S. boards to amend the bylaws of the corporation. American case law might restrict directors' conduct, though it does not provide clear guidance, since relevant case law is principally related to proxy fights or defensive measures for takeovers, such as super-majority requirements.

582 See very interesting debate on board elections enfolding during Symposium held by Harvard University, Lucian Bebchuk (editor), 'Symposium on Corporate Elections', *Harvard, John M. Olin Center for*

Recently, this rule has been enacted by the SEC, however it is not yet effective. Under this new Exchange Act Rule 14a-11, companies are required, under certain circumstances, to include a shareholder nominee or nominees for director in company proxy materials. Under the rule, companies will be required to include shareholder nominees for director in the company's proxy materials, if the shareholder meets certain conditions, and if the shareholders are not otherwise prohibited – either by applicable state or foreign law or a company's governing documents – from nominating a candidate for election as a director.[583] The most notable condition is that the shareholder seeking to invoke SEC Rule 14a-11 must not seek to change the control of the issuer or to gain more than a limited number of seats on the board.[584] Thus, the rule does not permit a 'change of the guard', but simply provides a mechanism whereby shareholders can have a more meaningful tool to influence their corporation's governing structures.[585]

Other general formal requirements for including shareholder proposals in the proxy statement are: 1) shareholders holding shares with a market value of USD 2,000 or 1% of the outstanding share are authorised, 2) shareholders are only allowed to make one proposal per year, this proposal has to be filed five months before the next annual meeting and the shareholder proposal has to be inserted into the proxy card and may not exceed 500 words.[586] [587] These procedural restrains make it difficult for shareholders to use the requisition right

Law, Economics, and Business, Discussion Paper no. 448, 11, 2003, the symposium brought together SEC officials, CEOs, directors, institutional investors, money managers, shareholder activists, lawyers, judges, academics, and others to discuss the subject from a wide range of perspectives. See also Grechten Morgenson, Who's Afraid Of Shareholder Democracy? The New York Times, October 2, 2005.

583 17 CFR Parts 200, 232, 240 and 249, release Nos. 33-9 136; 34-62762; IC-29384; File No. S7-10-09, RIN 3235-AK27 Facilitating Shareholder Director Nominations.

584 *See* Facilitating Shareholder Director Nominations, 74 Fed. Reg. 29,024, at 29,056–58.

585 Reed Schuster, 'Rule 14A-11 and the Administrative Procedure Act: it's better to have had and waived, than never to have had at all', *Minnesota Law Review*, forthcoming.

586 SEC Rule 14a-8, 17 C.F.R. 240. 14a-8 (1990).

587 But in the US, shareholders have been able to add other issues to the agenda through proxy fights that try to change and influence policy. These fights involve proposing a nonbinding resolution to influence the board, which is a right of expression. Because these resolutions do not mandate company action but try to influence the board through recommendations, they do not directly challenge the board's legal authority as raised in mandatory bylaws. These fights can involve corporate social behaviour, corporate governance issues and corporate strategy. This right of expression has influenced company behaviour. The increased use of the internet as reflected in the directive also generally reflects US law. For example, Delaware allows the participation in shareholder meetings using remote communications or the use of online meetings. In addition a shareholder can designate the proxy holder by electronic means. Similar to the directive, the federal proxy rules mandate e-proxy rules, which require companies and other soliciting persons to post their proxy materials on a publicly available internet website and provide shareholders with a notice regarding the availability of proxy materials on the Internet. Shareholders may now choose the means by which they access proxy materials either from the internet or paper copies and companies have some choice on how to deliver proxy material if the shareholder does not opt for paper delivery. Issuers and others that rely on the amendments may be able to lower the costs of their proxy solicitations although the amount of disclosure required under the proxy rules remain and possible liabilities for violating the proxy rules remain unchanged. Interestingly, in the US a number of companies have opted to continue to use paper materials because the use of e-voting actually reduced participation by individual shareholders which could give more power to larger institutional investors.

as a response to topical issues.[588] This gives the board time to prepare a defence to inform and convince the other shareholders. In the other systems, proxy solicitation and voting are mainly regulated through company law. Proxy voting/solicitation will be discussed in par. 3.5.

In the EU, the former draft art. 25 (1) 5th Dir. states that one or more shareholder, who ((art. 16), hold (a) shares of value *not* greater then 5%, (b) units not greater then 100,000, may request that one or more items be included in the agenda of a GMS. Art. 6 (1) Shareholder Rights Directive states that shareholders acting individually or collectively have the right to: a) put items on the agenda, b) table draft resolutions for items included or to be included on the agenda, art. 6 (2) outlines the requirement for the minimum stake not art. 6 exceed 5% of share capital, to (3) states that MS shall set a single deadline, with reference to a specified number of days prior to the general meeting or the convocation, by which shareholders may exercise the right to put items on the agenda of the general meeting. See also art. 9(1): every shareholder shall have the right to ask questions related to the items on the agenda of the GMS.

In the UK, as part of the process to convene a meeting the board, can stipulate the items which it wishes to have discussed at the meeting.[589] Under sec. 338 (1), (3) UK CA 2006, members representing at least 5% of the total voting rights of all the members entitled to vote on the proposed resolution, or 100 members holding shares in which there has been paid up an average sum, per member, of at least GBP 100, may require the company to give notice of their resolutions which can then be considered at the next GMS.[590] However, the company is not bound to give notice of the resolution (sec. 338 (2) when (2) (a) UK CA 2006) if (a) it would, be passed, be ineffective, (b) it is defamatory of any person, or (c) it is frivolous or vexatious. Under sec. 317 (1) UK CA 2006, the company is not required to circulate a member's statement if the court is satisfied, on application of the company or any other aggrieved person, that the rights under sec. 314 UK CA 2006 have been abused.[591] Another condition is that the requisition, identifying the resolution of which notice is to be given, must be received by the company at least six weeks before the GMS or before the company gives notice to the members of the GMS (sec. 338 (4) UK CA 2006) and the length of the requisition is limited to a 1000 words (sec. 314 (1) UK CA). Finally, those requesting the circulation must pay for it (sec. 340 (2) UK CA 2006); the circulation shall only be free if the request is received before the end of the financial year preceding the meeting, which may be up to six months before

588 Dirk A. Zetzsche, 'Shareholder Interaction Preceding Shareholder Meetings of Public Corporations. A six country comparison', *European Company and Financial Law Review*, Vol. 2, No. 1, CBC-RPS, no. 0003, 2005, p. 17.

589 Gower and Davies, Principles of Modern Company Law, Sweet & Maxwell, London: 2008, p. 446.

590 See sec. 338 (2) UK CA unless (2) (a) it would, if passed, be ineffective, (b) it is defamatory of any person, or (c) it is frivolous or vexatious. Gower and Davies, Principles of Modern Company Law, Sweet & Maxwell, London: 2008 p. 447, important to note is that the 100 "members" may include those who are not members of the company but whose interest in the shares arises form the fact that a member of the company holds the shares on their behalf in the course of a business and – a very important limitation – the indirect investor has the right to instruct the member how to exercise the voting rights.

591 Gower and Davies, Principles of Modern Company Law, Sweet & Maxwell, London: 2008, p. 419.

the meeting is held (secs. 340 (1), 437 and 442 UK CA 2006).[592] A practical problem with the member's resolution procedure is that the minimum period of notice for calling the GMS is 21 days (sec. 307 (2) UK CA 2006), for listed companies the recommend period is rather longer (sec. D.2.4 CC, 20 working days). Hence, members (UK members = shareholders, see ch.1) will have limited time to respond to the GMS documentation and to get their resolution to the company within the six-week limit.[593] For meetings other than the GMS, there is no statutory procedure whereby members can add an item to the agenda of meeting called by the board. Of course 10% of the members can convene a meeting themselves and put a resolution on the agenda of that meeting.

According to *German* law, shareholders have a right to supplement items on the agenda of the meeting they hold 5% or EUR 500,000 of the issued capital (§ 122 (2) AktG). The purpose of this agenda right is shareholder minority protection.[594] Shareholders can exercise this right when they hold their shares for more then 3 months (§ 142 (2) AktG).[595].Shareholders in Germany according to § 124 (1) (2) AktG are also allowed ten days after the notice of the meeting to put items on the agenda.[596] Shareholders can therefore use the proposal right for both an *initiative*, which will be included in the first notice of the meeting, and a *response* to the management's notice of the meeting.[597] It is important to note that in Germany, the power to exclude a proposal from the meeting's agenda is formally vested in the management.[598] The same limitations apply as to the right to convene a meeting as analysed in par. 3.4.1. Thus the German BoM/SB has the power to exclude an item from the agenda if related 'the ordinary business'. The management board has to decide autonomously whether it wants to take such measure and if it requires the approval of the general meeting. As we have seen in *Gelatine* this only applies in exceptional cases. The general meeting cannot take the initiative in those cases.[599] Shareholders also cannot utilise the proposal right to oppose a management proposal. The proposal right merely enables shareholders to add an item to the

592 However, the costs of circulation should not be large if the members' resolution can be circulated along with the general circulation for the AGM. The company is obliged to circulate the resolution with the notice if this is possible (sec. 339 (1) UK CA 2006.

593 Gower and Davies, Principles of Modern Company Law, Sweet & Maxwell, London: 2008, p. 447.

594 Ziemons in K. Schmidt/Lutter (eds.), Kommentar AktG, 2008, § 122.

595 Ziemons in K. Schmidt/Lutter (eds.), Kommentar AktG, 2008, § 122. Cf. Also Dirk A. Zetzsche, 'Shareholder Interaction Preceding Shareholder Meetings of Public Corporations. A six country comparison', *European Company and Financial Law Review*, Vol. 2, No. 1, CBC-RPS, no. 0003, 2005, p. 7.

596 P.P.M. Gozbach, 'Shareholder democracy: an analysis of the regulatory framework in Germany', *TvOB* 2008, p. 160, applications in respect of any of the items of the agenda may be raised regardless of the quorum required pursuant § 122 (2) AktG or the notification in the general meeting pursuant to § 124 4 AktG. The claim to put down on the agenda further items may be raised during the whole financial year up to the next annual general meeting, even after the convening of the same (see § 124 (2) (2) AktG). However, the general meeting is only allowed to resolve upon such items of the agenda that properly have been made known (§ 124 (4) AktG).

597 Consequently, shareholders of German companies can pursue both a long-and a short-term strategy, and they do not need to inform management about their strategy until very shortly before the meeting.

598 Dirk A. Zetzsche, 'Shareholder Interaction Preceding Shareholder Meetings of Public Corporations. A six country comparison', *European Company and Financial Law Review*, Vol. 2, No. 1, CBC-RPS, no. 0003, 2005, p. 22.

599 P.P.M. Gozbach, 'Shareholder democracy: an analysis of the regulatory framework in Germany', *TvOB* 2008, p. 160. Cf. also *Werner* in: Großkommentar zum Aktiengesetz, 4. edition 1992 et seq., § 122 note 27; *Semler* in: Münchener Handbuch des Gesellschaftsrechts, Part 4: Die Aktiengesellschaft, 3. edition 2007, § 35 note 16; see also OLG Frankfurt DB 2005, 1207.

agenda, in order to let all shareholders decide upon the proposal. Exercising the proposal right is invalid if the item is already on the agenda (since management will have put it on the agenda).[600] According to §§ 126/127 AktG, shareholders can bring in counterproposals with regard to items on the agenda.[601]

The Netherlands: art. 2:114a (1) NCC allows shareholders owning 1% or more of the shares or representing a value of EUR 50 million to propose an item (for discussion) on the GMS agenda. This threshold of 1% was introduced in 2004 with the "Structuurregeling" amendment,[602] but will be raised again to 3%.[603] Art. 2:114a (3) NCC states that the articles can lower these thresholds, art. 2:114a (4) NCC states that certificates of shares (preferential shares) are treated equivalently. According to art. 2:114a (1) NCC, a shareholder's request to add an item to the agenda has to be filed with the company 60 days before the meeting. If filed in time the item will be inserted in the notice of the meeting or announced in similar way, unless 'important interests of the corporation' oppose such insertion of a shareholder's proposal. This refusal right of the company (BoM) does not entail a substantive but merely a formal test related to the discipline of the meeting (cf the general test as to whether a shareholder has 'abused' his agenda right arts. 2:8 NCC and 3:13 NCC 'abuse of law').[604] Art. 2:107 (2) NCC stated that the BoM and the SB will give all required information to the GMS, unless 'important interests of the corporation' resist such a request containing a substantive test, for example if providing the GMS with certain information will damage the competitive position of the firm. The Dutch broad shareholder's agenda right played an important role in the break-up of ABN-AMRO in 2007. It was TCI's proposal for a split translated into five items on the general meeting agenda of ABN-AMRO that effectively accelerated the actions of ABN-AMRO's board and the completion to acquire its control. Note that TCI's items for the agenda were all within the corporate power of the board (art. 2:129 NCC). Therefore these items

600 Dirk A. Zetzsche, 'Shareholder Interaction Preceding Shareholder Meetings of Public Corporations. A six country comparison', *European Company and Financial Law Review*, Vol. 2, No. 1, CBC-RPS, no. 0003, 2005, p. 17.

601 Ziemons in K. Schmidt/Lutter (eds.), Kommentar Aktiengesetz 2008, §§ 136/127. Cf. also Dirk A. Zetzsche, 'Shareholder Interaction Preceding Shareholder Meetings of Public Corporations. A six country comparison', *European Company and Financial Law Review*, Vol. 2, No. 1, CBC-RPS, no. 0003, 2005, p.24 Every shareholder of a German company can demand that the company publish a shareholder's opposing or dissenting statement on an (already announced) agenda item after the notice of the shareholder meeting. This statement may include a Draft Resolution and arguments as to why shareholders should vote in favour of the Draft Resolution. This right of Counter Motion can be exercised up to two weeks before the meeting.

602 Law Gazette 2004, 370. Cf. Frans Overkleeft, 'Het agenderingsrecht voor aandeelhouders in beursvennootschappen: een aanzet tot (her) bezinning', *Ondernemingsrecht* 2009, 167.

603 The Commission Frijns recommendates to raise het threshold from 1% to 3%, Parliamentary Papers 31 083, nr. 1. see the use of the 1% requirement in the Stork and ABNAmro –case. See also proposal of bill (Parliamentary Papers 32 014), following the advice of the Monitoring Committee Corporate Governance Code of May 30, 2007, is in preparation and will include legislation that enable the listes public company to establish the identity of its shareholders

604 Cf. Frans Overkleeft, 'Het agenderingsrecht voor aandeelhouders in beurs-vennootschappen: een aanzet tot (her) bezinning', *Ondernemingsrecht* 2009, 167. He points out that in the explanatory memorandum the legislature noted the following on the "important interests of the corporation-test'': "In refusing to add a subject to the agenda, the interests of the company shall be paramount. "Important interests" means that a refusal will not easily justified. Rejection of an application for adding a subject to the agenda is conceivable when a series of items appears to be proposed solely for the purpose to distort the proceeds of the meeting."

should be qualified as mere *motions,*constituting, if adopted, non-binding expressions of the GMS opinion. Compared to the US precatory shareholder proposals (apart from international market dynamics/pressure), such motions may really intrude into the supremacy and discretion of a Dutch issuer's board (BoM/SB), since it lacks the clear discretion to refuse an item for the agenda related to the ordinary business, as prevails in the US and German systems. A major difference results from the power to 'enforce' the strategy of activist investors through a request for an investigation-procedure with the Netherlands Enterprise Chamber as also applied in this case. It was not the 'agenda right' itself but the Dutch erosion of board supremacy resulting from the application of the investigation procedure that seemingly caused insecurity for boards as to how to properly react to activist shareholders/ offerors and probably blurred the board's judgement that, within the prevailing parameters, they simply could have responded: "no"! (See further: chapter 4).
Recently, the Bill to implement the Shareholder Rights Directive,[605] propose two amendments to art. 2:114: 1 NCC) a request for putting an item on the agenda should clearly explain its grounds, hand 2) abolishment of the corporation's right (art. 2:114a (1) NCC) to refuse such a proposal because of 'important interests of the corporation'. This seems to strengthen the right of shareholders to put an item on the agenda, since the board's discretion to reject such a proposal is decreasing. This, however, does not affect the basic rule that only resolutions on subjects within the power of a GMS are legally binding. Nor does it affect 'motions' to be voted on (which may be the basis for a petition for an investigation procedure (see below: par. 3.5 and chapter 4)). Thus such motions will appear to become 'instructions' by the GMS to the board. However, recent case law of the Supreme Court (*ASMI*-case) seems to re-establish board supremacy and discretion, including refusal of agenda items and neglect of 'instructive motions'.

3.4.3 'Rights' of investors-shareholders and 'duties' of issuer's board to have a 'dialogue' with the issuers' investors.

In recent years, 'activist' shareholders have pressed issuers and their boards to be responsive to their own views on alternative strategy and policies, starting with presentations to and discussions with the board, but often followed by public disclosure of their views, communication with other shareholders and the investment community, setting the stage for voting advisers (ISS), analysts and the financial press. It was the sequence of events for some major cases in the Netherlands as well, such as ABNAMRO and Stork. Building their case dialogues with the issuer's board would strengthen their position in the market. On the other hand, issuers themselves have an interest in good relations with their investors, particularly institutional and other major investors. Their investor relations policy usually includes regular contact with such institutional and major investors.

605 Lower House 2008-2009, 31 746, nr 2, Wetsvoorstel Wijziging Boek 2 en Wft ter uitvoering Richtlijn inzake aandeelhoudersrechten, Proposal of Bill is pending with First Chamber of the Parliament. Simultaneously with this proposal of bill another proposal of bill (Parliamentary Papers 32 014), following the advice of the Monitoring Committee Corporate Governance Code of May 30, 2007, is in preparation and will include legislation that enable the listes public company to establish the identity of its shareholders; R.G.J. Nowak, 'Het wetsvoorstel ter uitvoering van de Shareholders Directive', *Ondernemingsrecht* 2008, 183, p. 620.

US *practice* seemingly, as in the UK, shows an approach by (institutional) shareholders as part of their investor relations policy. However, rules (principles, best practices) do not exist and, again, the market-oriented disclosure system indicates strict securities law rules on inside information and disclosure of price-sensitive information will prevail (as in the EU according to the Market Abuse Directive). If activist shareholders want to increase pressure they can solicit proxies and start a proxy contest and/or try to table proposals to shareholders, but a refusal to continue the 'dialogue' with the issuer's board cannot be construed as infringement of any 'rights' of investors. The issuer under the Delaware statute may establish that parties respectfully agree to disagree.[606]

The EU and its Member States seem to be moving in the direction of strengthening shareholder's power, at least in the Shareholder Rights Directive on that subject, which aims to take away technical constraints to communication with shareholders. Whereas US proxy rules are part of securities regulation focussing on disclosure instead of aiming at shareholder democracy, the EU Shareholders Rights Directive takes the latter perspective. This conceptual difference seems already to influence board supremacy when activist shareholders target an (undervalued) corporation and its board. This topic will be further analysed in par. 3.6.

Fitting into the UK market and City tradition,[607] the UK CC (note: part of the LSE listing rules[608]) was the first to provide (sec. D1 on dialogue with *institutional* shareholders): 'there should be a dialogue, based on mutual understanding of the objectives. The board as a whole has responsibility for ensuring that a satisfactory dialogue with shareholders takes place'. The supporting principle reads: 'whilst recognising that most shareholder contact is with the chief executive and finance director, the chairman (and the senior independent director and other directors as appropriate) should maintain sufficient contact with major shareholders to understand their issues and concerns.' The board should keep in touch with shareholder opinion in whatever ways are most practical and efficient. The chairman should ensure that the views of shareholders are communicated to the board as a whole. The chairman should discuss governance and strategy with major shareholders. Sec. D.1.2 UK CC: 'The board should state in the annual report the steps they have taken to ensure that the members of the board, and in particular the non-executive directors, develop an understanding of the views of major shareholders about their company, e.g. through direct face-to-face contact, analysts' or brokers' briefings and surveys of shareholder opinion.' See also sec. E.1 UK CC *institutional* shareholders should enter into a dialogue with companies based on the mutual understanding of objectives. Thus the focus is on good investor relations with *institutional* shareholders.

In *Germany* the topic of a dialogue with (institutional) shareholders as such is not regulated in statutory law nor in the GCGC.

606 US ALI Principles.

607 John Armour and David A. Skeel, 'Who Writes the Rules for Hostile Takeovers, and Why? The Peculiar Divergences of US and UK Takeover Regulation', *ECGI Law Working Paper No. 73,* 2006, p. 1727. See also the work of Mark J. Roe, *Strong Managers, Weak Owners: The Political Roots of American Corporate Finance,* Princeton, New Jersey: Princeton University Press 1994.

608 If the company is not adhering to the UK CC a possible but presumably theoretical possibility is that the LSE would sanction a refusal to adhere to the UK CC by delisting the issuer.

The Netherlands[609] shows a somewhat different picture since DCGC rules appear to have been to a certain extent accepted to be as 'enforceable' as 'customary' rules (generally accepted principles) under the umbrella of its general corporate law principle that the internal affairs of a corporation shall be governed by reasonableness and fairness (art. 2:8 NCC, see chapter 4 for further analysis). The DCCG confirms the 'constituency' character of statutory corporate law. Management shall balance the various interests in pursuing its tasks. Stakeholders, including investors, may follow and prioritise their own interests, but with due regard to the principles of reasonableness and fairness (Preamble DCGC, no. 9). Following the example of the UK CC but deviating from its limitation to institutional investors and focussing on the Dutch market, the DCGC proclaims that good relations between stakeholders (also shareholders) are of great importance, *particularly through a continuous and constructive dialogue* (Preamble DCGC, no. 10). Best Practise IV.4 DCGC reads: 'shareholders shall act in relation to the company, the bodies corporate of the company and their fellow shareholders in keeping with the principle of reasonableness and fairness. This includes the willingness to engage *in a dialogue with the company and their fellow shareholders'*. Is the board *obliged* to enter into a dialogue[610] with *all* shareholders and other stakeholders on its strategy and policies?[611] The Amsterdam Enterprise Chamber decided affirmatively in investigation procedures initiated by hedge funds to attack the prevailing strategy and policies;[612] its decisions with respect to the binding and enforceable nature of DCGC 'norms' were upheld by the Supreme Court, but at the same time the principle of board supremacy was strongly confirmed (chapter 4 will elaborate the investigation procedure with the Amsterdam Business Court).
This illustrates that shareholder activism is more successful in some jurisdictions than in others and that a proper distinction between securities regulation and corporate law to protect investors is a key element. (Broad private) enforcement seems to be the explanatory factor. Obviously this will influence board supremacy (see chapter 4).

609 See the AFM's concept policy measure 'investor recommendations', in which the supervisor determines under which conditions information is considered to be 'public'. This policy measure will replace the policy measure of 12-12-2006 (06-03).

610 The meaning of the word 'dialogue' presupposes an equality of arms between two 'parties' having a conversation about a certain topic. From this concept seems to follow and seemingly presupposes that (groups) of shareholders having a dialogue with the board on the corporation's strategy and policy also have or should have a role in determining corporation's strategy.

611 Preamble (no.5) of the DCGC states that 'both shareholders and the management and supervisory boards should be prepared to enter into a dialogue on the reasons for any departures of the Code.' This could already be considered as a departure from Dutch law in which the board is supreme and it seems a further-going obligation that is imposed on the board then just to 'comply or explain' the principles of the Code. Compare this to the Preamble (no. 5) of UK CC where the company only has to give a clear explanation to its shareholders when the company chooses not to comply with a certain provision of the code, and see Preamble (no. 7) which states that institutional investors themselves should be prepared to have a dialogue with the company if they do not agree on the compliance of UK CC by the company.

612 Supreme Court 13 July 2007, JOR 2007, 178, 434 (ABNAMRO), AA (2007), p. 734-743 with annotation Raaijmakers. The comment of Eumedion proposing that when the legislator will stay with its proposal the corporation have to provide the shareholders with a detailed overview of the strategy is also against the division of powers. More than price sensitive information.

Meanwhile a Bill is pending, following the advice of the Netherlands Monitoring Commission Corporate Governance,[613] obliging shareholders with more than 3% of the issued capital or voting rights to disclose whether or not they oppose the issuer's strategy/policy. The Bill aims at improving 'constructive dialogue', but does not clearly explain how that result can be achieved.[614] Submission of the issuer's strategy for GMS approval would already contradict the mandatory division of powers between board, supervisory board and shareholders.[615] The proper connection seems to be the system of § 13A SEA'34 as implemented by the Williams Act 1968 and related to a takeover context and aims for informing the other investors of a 'creeping' takeover. See also 13D ('intent') and RNA-rules, as discussed in par. 3.3.10.

3.4.4 Annulment of GMS resolutions

The preceding paragraphs discussed the collective, group and individual rights and powers of investors, as well as specific supporting court actions, in and with respect to the issuer's internal organisation, the GMS and the division of powers. These may not prevent resolutions being taken by majority vote that may infringe shareholders' substantive, procedural rights and their claims under securities law.[616]

In the traditional view of the corporation as an 'association' with 'members'[617], one of the major enforcement mechanisms is a corporate law cause of action in court to annul resolutions taken by the GMS (or another body corporate).[618] This rescission right evidently is particularly important to protect minorities in 'block-holder' systems against a major shareholder. It is, of course, less important in a system, as in the US, where the issuer's shares are widely dispersed, which does not prevent board resolutions being 'attacked'. US courts, however, apply the BJR and, hence, will refuse to review and 'second guess' (operational) board decisions. In the examined systems, the nullification (or judicial confirmation of a decision being void) of board decisions appear to be of no major practical importance. However, the Dutch investigation procedure effectively allows for board and GMS decisions to be annulled by way of injunctive relief (art. 2:349 NCC) and, hence, provides a means

613 Lower House, Parliamantary Papers, II, 2008/2009, 32 014, no.1-5.

614 See the Comments on this proposal by Eumedion, 29 September 2009.

615 Cf. Charles Honnee, investors relations en de kunst van het laveren, in: De nieuwe macht van de kapitaalverschaffer, Uitgave vanwege het instituut voor Ondernemingsrecht, nr. 57, p. 13-29), p. 26, he makes disclosure of SH's intentions a condition for having a dialogue with the issuer, in that sense the disclosuer of these intentions functions a requirement to be admissable to that dialogue. PvdS: in the US, however this kind of requirements are part of § 13 (d) SEA, in case of a possible takeover investors must disclose their intentions when aiming for control of the issuer.

616 Cf. Gower and Davies, Principles of Modern Company Law, Sweet & Maxwell, London: 2008 p. 649, in any company law system a number of techniques are in principle available to control the exercise by the majority of the shareholders of voting power over the company in an unfair way. E.g., the legislature could specify in advance certain decisions which should not be open tot the majority to take.

617 This suits the more continental view of the legal form of the public corporation. Cf. Raaijmakers, *Ondernemingsrecht, Pitlo/Raaijmakers,* Deventer: Kluwer 2006, p. 573.

618 Mathias Siems, *Convergence in Shareholder Law*, Cambridge University Press 2008, p. 218, protection against abuse by the shareholders majority becomes acute particularly where resolutions of the general meeting threaten to injure the interests of the minority. The examined jurisdictions accordingly provide that individual shareholders can defend themselves against unlawful resolutions of the general meeting but also decisions of other corporate bodies.

to attack board decisions. This had and seemingly still has its profound influence on the supremacy of the Dutch board. This analysis will explained further in chapter 4. A short overview follows.

In the US and UK, there are no detailed statutory provisions; case law primarily regulates the annulment of decisions.[619] Actions against general meeting decisions are admissible in principle, but tend to be of minor importance.[620] However, typical US appraisal rights may offer an alternative in protecting minority shareholders. See also sec. 994 UK CA 2006 as an alternative for minority protection that provides that any member may petition the court for relief under certain conditions.[621]

The *German* § 243 AktG allows for challenging the meeting's decision on the ground that the decision violates either a statutory provision or a provision of the articles of association.[622] This not only pertains to the substance of the decision, but also to the procedure through which the decision was established.[623] The decision cannot be challenged after a one-month time limit for appeal has expired (§ 246 (1) AktG). No limitation is set for violation of fundamental rules and principles and resolutions taken at inadequately called meetings (§ 241 AktG). In severe cases, a decision is void by law (§ 241 AktG). An action for nullity is regulated in §§ 249 (1) AktG and 248 (1) AktG. A particular rule is that a decision is deemed to be valid if no action for nullity has been started within three years of the resolution's entry in the commercial register (§ 242 (2) AktG).[624] A personal interest in the respective resolution is not a precondition for filing the suit.[625] The costs are in principle paid by the losing party (§ 91 GerZPO). Recently this became an incentive for (activist) shareholder/ investors to reach a settlement with the company. These shareholders could pressure management because they could block entry of the resolution into the commercial register until a final decision had been made on its alleged voidness (§ 127 GerFGG). These actions, often qualified as abusive, usually started with a rescission suit claiming that their statutory rights as provided by the AktG were violated, such as a claimed breach by the company of

619 See e.g. the US case *CSX v. The Children's Investment Fund (TCI),* U.S. District Court for the Southern District of New York, 11-06-2008, Case 1: 08-cv-02764 LAK.

620 Mathias Siems, *Convergence in Shareholder Law*, Cambridge University Press 2008, p. 220. Cf. also James D. Cox and Thomas L. Hazen, *Corporations, 2*nd *edition*, New York: Aspen 2003, §§ 22.23, 23.02. UK: *Edwards v. Halliwell* [1950] 2 All ER 1064, 1067 (Court of Appeal). Notably in the US and the UK no pure voidability of decisions is provided for. In the tradition of the ultra vires theory, now largely abandoned in relation to management actions, unlawful decisions are null even if not proceeded against.

621 Sec. 994 UK CA 2006 that provides that any member may petition the court for relief under certain conditions: a) the company's affairs are being or have been conducted in a manner which is unfairly prejudicial to the interest of its members generally or some part of the members (including at least himself) or b) that any actual or proposed act or omission of the company (including any act or omission on its bealf) is or would be so prejudicial.

622 § 243 (1) AktG, Ein beschluss der Hauptversammlung kann wegen Verletzung des Gesetzes oder der Satzung durch Klage angefochten worden.

623 This is part of the traditional German concept which perceives the individual shareholder to be the watchdog of management, the supervisory board, and majority shareholders.

624 See Ulrich Noack and Dirk Zetzsche, 'Germany's Corporate and Financial Law 2007: (Getting) Ready for Competition', *Heinrich-Heine-University Dusseldorf-CBC-RPS 0028,* June 2007.

625 Erik P.M. Vermeulen & Dirk A. Zetzsche , 'The Use and Abuse of Investor Suits', *TILEC Discussion Paper, DP 2010-001*, January 2010, p 32, It is the theory behind the design of the rescission suit that by filing the rescission suit, shareholders, while pursuing their own interests, simultaneously pursue the interest of the corporate or overall shareholder constituency.

their (broad) right to information (§ 131 AktG).[626] The enactment of UMAG[627] (2005) tried to tackle these abusive suits and aimed at tightening the right to contest GMS decisions. One of these reforms introduced a provision (§ 243 (4) AktG)[628] which clarifies that the failure to provide information which a reasonable shareholder would not consider relevant for his voting decision, does not justify contesting of a shareholder meeting's decision.[629] Also a special shareholders' *compensation* procedure (Spruchverfahren) has been developed with the aim of preventing obstructive actions.[630] If the appropriateness of the compensation is tested separately, the threat to have the GMS decision suspended or rescinded on those grounds alone may be dropped.[631] The Spruchverfahren is permissible in situations where the company's value is concerned (mergers, acquisitions, amalgamations etc.). The last exclusionary reason is particularly relevant in the context of freeze-outs and fundamental changes, the validity of which were frequently threatened by strike suitors until the adoption of the UMAG.[632] The UMAG also introduced a general release procedure; courts can order that, despite a pending claim against a decision by the general meeting, it can be entered in the commercial register (§ 246a AktG).[633] If the court of first instance (in the preliminary proceeding[634]) holds that the measure may take place and the court of last resort eventually finds the measure to be illegal, the claimants may be reimbursed for their damages. The measure itself, however, will nevertheless be deemed to be legal by the force of the

626 See Ulrich Noack and Dirk Zetzsche, 'Germany's Corporate and Financial Law 2007: (Getting) Ready for Competition', *Heinrich-Heine-University Dusseldorf-CBC-RPS 0028,* June 2007, p. 18, from the traditional point of view – the AktG generously assigned rights to challenge the meeting's decision to shareholders as part of the traditional watchdog-function of the shareholders. Related to the information right of shareholders (§ 131 AktG), previously, an individual shareholder could ask any question related to the topics that the meeting was called to vote on and management was required to answer these questions. Failure to fully answer such questions could lead to the contesting of the shareholder meeting's decision.

627 Gesetz zur Unternehmensintegrität und Modernisierung des Anfechtungsrechts (UMAG) of 22-09-2005, BGBl.I 2802.

628 Cf. Schwab in: K. Schmidt/Lutter (eds.), Kommentar Aktiengesetz, 2008, § 243 (4).

629 Ulrich Noack & Dirk Zetzsche, 'Die *Informationsanfechtung* nach der Neufassung des § 243 Abs. 4 AktG' , *170 ZHR,* 218, 226, 2006

630 Mathias M. Siems, *Convergence in Shareholder Law*, New York: Cambridge University Press, 2008, p. 219.

631 Mathias M. Siems, *Convergence in Shareholder Law*, New York: Cambridge University Press, 2008, p. 219.

632 Ulrich Noack and Dirk Zetzsche, 'Germany's Corporate and Financial Law 2007: (Getting) Ready for Competition', *Heinrich-Heine-University Dusseldorf-CBC-RPS 0028,* June 2007, p. 19, the validity of freeze-outs and fundamental changes were frequently threatened by strike suitors until the adoption of the *UMAG.* Cf. also Erik P.M. Vermeulen & Dirk A. Zetzsche, 'The Use and Abuse of Investor Suits', *TILEC Discussion Paper, DP 2010-001*, January 2010.

633 Mathias M. Siems, *Convergence in Shareholder Law*, New York: Cambridge University Press, 2008, p. 219. See § 246(a) (4) AktG, If the court of first instance (in the preliminary proceeding) holds that the measure may take place and the main court eventually finds the measure to be illegal, the claimants may be reimbursed for their damages. The measure itself, however, will nevertheless be deemed to be legal by the force of the preliminary judgment.

634 In 2009 the preliminary procedure was amended; since 1 November 2009, this procedure is a one instance only procedure in front of the *Oberlandesgericht* (Higher Regional Court, Appeal Court) which must issue a decision within three months or account for delays in writing. In urgent cases, the *Oberlandesgericht* may forego an oral hearing and decide on the basis of written facts. See § 246a (1) and (3) of the *Aktiengesetz* and § 16 (3) of the *Umwandlungsgesetz*, as amended.

preliminary judgment.[635] Compare this to the Dutch *Versatel*-case[636] in which the integration of Versatel in Tele2 was put on hold primarily for validation reasons of buy-out by a minority as consequence of a legal merger of Versatel in a subsidiary of Tele2. The German 'Spruchverfahren' and rescission suit are two different procedures, any claim that a compensation for shares is inadequate belongs to the domain of the 'Spruchverfahren'. The Netherlands Investigation procedure does not provide similar procedural clarity. The function of this 'Spruchverfahren' is quite similar to the US appraisal procedure (§ 262 (c) DGCL), it prevents shareholders from blocking a transaction; it suits a market-oriented system in which investors are protected by giving them the right to have the fair value of their shares determined and paid to them in cash, not a sale of the shares to a third party[637]. Cf. also the squeeze-out and sell-out-rights under the 13th Directive.

In the *Netherlands*, a decision of the GMS, or another organ, is void if the decision violates a statutory provision or a provision of the articles of association. This article safeguards the mandatory division of powers between the board and the GMS as prescribed by statute and fixed in the articles of incorporation. This article thus allows enforcement of rules regulating the internal division of powers in the organisation of the company.[638] Furthermore, in the Netherlands any regular court could void resolutions on the grounds that a) the decision violates either a statutory provision or a provision of the articles of association regulating the realisation of decision (art. 2:15 (1) (a)), b NCC) in case of violation of notions of reasonableness and fairness as required by art. 2:8 NCC: shareholders, but also the board and the company itself, are prevented from exercising a right if its exercise disproportionally harms other shareholders, the management board, the supervisory board or the corporation itself,[639] and c) in case of violation of regulations.[640] In principle, art. 2:16 NCC will protect third parties if a decision of the company is rescinded.

The Dutch investigation procedure with the Enterprise Chamber of the Amsterdam Court of Appeals (hereafter: "investigation procedure") also provides the possibility to void decisions of the GMS, but also of other organs of the company. This procedure is unique and does not exist in the US, the UK or in Germany. This procedure allows – also for issuers – immediate and final injunctive relief (arts. 2:349a NCC and 355) if, according to the court, the state of affairs so requires. In recent years this procedure and the possibility for (immediate) injunctive relief has developed into a very accessible, quick and extremely effective weapon for activist shareholders, especially in formal or material takeover conflicts and to put pressure on boards to change strategy and policy (break up scenario, buy-backs, exit appraisal).

635 See Ulrich Ulrich Noack and Dirk Zetzsche, 'Germany's Corporate and Financial Law 2007: (Getting) Ready for Competition', *Heinrich-Heine-University Dusseldorf-CBC-RPS 0028,* June 2007, p. 20. Erik P.M. Vermeulen & Dirk A. Zetzsche, 'The Use and Abuse of Investor Suits', *TILEC Discussion Paper, DP 2010-001*, January 2010, p. 37, Any claim arguing that the level of compensation is inadequate, or that wrongful information has been given with respect to the compensation, does not belong to the domain of the rescission suit, if the evaluation proceeding is available.

636 Amsterdam Enterprise Chamber 14-12-2005, AA 2006, 198 (Versatel) with annotation Raaijmakers.

637 Stephen M. Bainbridge, *Corporate law and Economics (2nd edition)*, Foundation Press 2009, p. 179.

638 Raaijmakers, *Ondernemingsrecht, Pitlo/Raaijmakers,* Deventer: Kluwer 2006, p. 572.

639 Work council as well.

640 Erik P.M. Vermeulen & Dirk A. Zetzsche, 'The Use and Abuse of Investor Suits', *TILEC Discussion Paper, DP 2010-001*, January 2010. Empirical data shows that this type of 'rescission suit' is mainly used by directors to challenge dismissal resolutions and notices.

Shareholders who alone or together own 10% of the shares or shares representing the nominal value of EUR 225.00 (as well as related trade unions). (arts. 2:346/347 NCC).
This investigation procedure deviates from usual litigation and rescission suits (art. 2:15, also art. 2:15 (3) reasonable interest), since it may be initiated by a petition rather than an indictment and, hence, the court has great freedom to direct the course of this procedure. These procedural differences have a significant influence on the position of the 'plaintiffs' (formally: petitioners) and, hence, on the 'target' corporation and its board as 'defendants'. The boundary between the rescission suit (arts. 2:15 and 2:14) and the investigation procedure has been somewhat blurred. The Entrerprise Chamber may also annul a decision of the GMS as well as of the board or supervisory board. The court may regulate the consequences of the given rescission. In the case of a listed public corporation, these procedural differences had a major influence on the court's assessment of board supremacy. Its findings on this subject have been overruled by the Supreme Court. This and other possibilities for shareholder's litigation will be further discussed in Chapter 4.

3.4.5 Correction (restatement) of the annual accounts

With reference to chapter 2 the US SEC has the power to force upon an issuer a restatement of disclosure documents. In the UK, the Secretary of State has this power, other persons require his permission to ask for correction of the annual accounts, secs. 455-458 UK CA 2006. The German Gesetz zur Kontrolle von Unternehmnesabschlüsse provides the Bundesanstalt with this authority, which can rely on a 'Prüfstelle' for this purpose, § 342b HGB and Wertpapierhandelsgesetz §§ 37n-37u. In the Netherlands, arts. 2:447-453 NCC, along with the AFM, provides that each person with a due interest and shareholders can request for correction of the annual accounts.

3.5 Preliminary conclusions

Shareholders' procedural pre-meeting rights and also possibilities for (broad) enforcement, such as the right to rescind decisions of the GMS (but also of other organs of the company), determine the division of power between the board and the shareholders and also influence the supremacy of the board to execute its strategy and policy.
In the US, the pre-meeting rights of shareholder as well as the rescission right reflect the US market-oriented system which aims at protection of investors. The US board effectively controls the charter. US shareholders can vote on issues that are beyond their powers, since the board decides on matters related to the ordinary business. Shareholders have the power to start a proxy contest or make (precatory) proposals.
The EU's (examined) MS all reflect their aim for minority protection. They all provide (under different thresholds) 'calling'-rights. In all systems, shareholders also have the right to put items on the agenda. The Netherlands until now provides a strikingly low threshold of 1% for placing items on the agenda. All systems (especially the US and Germany), except the Netherlands, have similar discretion as the US board not to convene a meeting and to refuse to put an item on the agenda when it is related to for example ordinary business. The UK board, under certain conditions, has the power not to convene a meeting and to refuse a resolution that cannot be 'properly' moved at the meeting. Notably, the board (BoM/SB)

of a Dutch public corporation has less discretion not only in refusing to convene a meeting, but also in refusing to put a right on the agenda. In the Netherlands, shareholders' motions, unlike the US precatory rights, in practice function as some kind of instruction right. Part of this mechanism is that DCGC-rules appear to be to a certain extent enforceable as 'customary' rules (generally accepted principles) under the umbrella of its general corporate law principle that the internal affairs of a corporation shall be governed by reasonableness and fairness (art. 2:8 NCC, see chapter 4 for further analysis). The same applies to the requirement to have a dialogue with shareholders and therefore seems to be enforceable.

In Germany and the Netherlands, shareholders have a right to rescind a decision of the GMS but also other organs, if the decision violates a statutory provision or a provision of the articles of association. However, because of abusive suits in Germany, the UMAG further developed the 'Spruchverfahren'-procedure. The German 'Spruchverfahren' and rescission suit are two different procedures, any claim that a compensation for shares is inadequate belongs to the domain of the 'Spruchverfahren'. The function of this 'Spruchverfahren' is quite similar to the US appraisal procedure (§ 262 (c) DGCL), in preventing shareholders from blocking a transaction; it suits a market-oriented system in which investors are protected by giving them the right to have the fair value of their shares determined and paid to them in cash. The Dutch investigation procedure with the Enterprise Chamber also provides the possibility to void decisions of the GMS, but also of other organs of the company. The investigation procedure, somewhat absorbing the normal rescission suit, does not offer the procedural clarity of that procedure and does not offer the procedural safeguards of a regular contra dictionary procedure. In the case of a listed public corporation, these procedural differences had a profound influence on the supremacy of the Dutch board (listed public corporation). In chapter 4 these influences and other possibilities for shareholder's litigation will be further analysed.

3.6 Combining shareholder's voting power: proxy solicitation and voting[641] (corporate & securities law)

The above comparative analysis of the dissemination of powers between shareholders (investors) and the board of an issuer ('public corporation') remains 'abstract' in the sense that it does not take into account the influence on practice of *de facto* dispersion of shares, block holdings, free float and market conditions.[642]

Now we turn to the bundling of shareholders' power, apart from pre-meeting rights, through concerted actions or the mechanism of proxy voting and targeted solicitation of proxies in the open market. All examined jurisdictions allow proxy voting: a shareholder is allowed to authorise someone else to vote on his behalf, albeit that 'purchasing' of votes

641 In this paragraph proxy solicitation and voting will be analysed. Postal voting by which a vote is cast directly by the shareholder who holds the vote without attending a meeting, will not be addressed.

642 For a more extensive analysis of shareholders' absenteeism, apathy and the more technical details of depositing evidential titles and 'record dates' reference is made to a variety of studies including the HLG Report (2002) and the EU directive to enhance shareholders' rights (2007).

may be restricted. The significance is evident. It allows the concentration and 'line up' of voting power to activate the voting power of passive or 'silent' investors and thus to acquire a decisive, blocking, prominent or at least influential vote. Institutional investors, pension funds and others have been under pressure to use their voting power to enhance the balance of powers within issuers. Specialised firms (such as RiskMetrics) advising on the use of voting rights emerged. Issuers, also in the EU, enhanced their investor relations and developed a growing interest in knowing their shareholders' constituency, also for communication (on top of prevailing disclosure). The concept of 'dialogue' should be understood in this context. Proxy voting/solicitation is a mechanism used by issuers that facilitates voting by mostly 'anonymous'/dispersed shareholders who cannot physically attend a meeting of shareholders.[643]

Proxies may be needed to ensure that a required quorum of shareholders will be present or represented at the meeting and valid decisions can be taken.[644] Regulation of voting by proxy is the subject of corporate law, the solicitation of proxies and the required disclosure to protect investors will be a subject of securities regulation. Conceptually this makes a difference. The former may be part of a tradition of corporate/governance aiming at shareholder democracy and the shareholder voice in the corporation and to underscore the monitoring function of investors; the latter also aims to improve shareholder voice as part of 'good' corporate governance. Thus if, how and on at what level (corporate or securities law) legal regimes have developed and are facilitating mechanisms and rules on proxy voting and solicitation may influence the division of power within the corporation.

This paragraph will discuss proxy solicitation and voting.[645] Rules on acting in concert, although important for shareholders trying to activate other investors, are not part of this analysis, nor are 'empty voting' and securities lending.

643 Stephen M. Bainbridge, *Corporate law and Economics (2*nd *edition)*, Foundation Press 2009, p. 247. Allen, Kraakman and Subramanian, *Commentaries and Cases on the Law of Business Organization (2*nd *Edition)*, New York: Aspen Publishers 2007, p. 185, Shareholder Meetings require a quorum to act. Given the widely dispersed share ownership of most publicly financed corporation, public shareholders are unlikely to actually attend shareholder meetings. As a result, in order to gather a quorum, the board and its officers are permitted to collect voting authority from shareholders in the form of proxies. Cf. also William A. Klein and John C. Coffee Jr., *Business Organizations and Finance, Legal and Economic Principles*, New York: Foundation Press 2004, p. 127.

644 Generally, proxies will be sought by companies for the annual shareholder meeting or other special meetings. Because so many publicly traded corporations are Berle-Means corporations and there is no controlling shareholders presence, proxies are often needed to be sure there is a quorum or a minimum number of shareholders present at the meeting in order to conduct business and to take whatever actions are needed. The frequent use of proxy voting historically in the US was a major reason that the SEA'34 gave the SEC broad powers to regulate proxies. The federal proxy rules are very detailed with its primary focus on disclosure with publicly traded corporations required to comply when proxies are solicited. But there is also state company law which actually provides the basis for this.

645 Mathias Siems, *Convergence in Shareholder Law*, Cambridge University Press, 2008, p. 96 explaining the different modes of communication between registered or bearer shares; with registered shares the identity of the shareholders should in principle be known, these shareholders are to be informed personally. For bearer shares by contrast the emphasis is on the public notice. Furthermore, financial intermediaries who have custody of shares can be obliged to forward information to bearer shareholders.

3.6.1 US proxy rules: disclosure function

US federal securities law is concerned mainly with disclosure obligations in the process of soliciting proxies, as well as procedural and antifraud rules designed to make the required disclosure more effective. In contrast, regulating the substance of corporate governance standards is a matter for state corporate law. This also applies to the rules concerning proxy voting and solicitation, a system regulated by the § 14 (a) SEA'34 and subsequent SEC rules.[646] The federal proxy rules are very detailed. Their primary focus is on disclosure by issuers required to comply when proxies are solicited *by themselves*.[647] Federal proxy regulation has two principal goals. First and foremost, it regulates the disclosures to be provided to investors whose votes are solicited.[648] § 14 (a) (c) SEA'34 and its proxy rules focus on disclosure. According to SEC Rule 14a-3 (b) proxy solicitation by the issuer itself for the election of directors at an annual meeting must be accompanied or preceded by an annual report to security holders that includes amonst others: 1) balance sheets for two years and income statements for three, all audited and prepared on a consolidated basis in accordance with Regulation S-X; 2) selected financial data; 3) management's discussion and analysis of financial condition and results of operation, etc.[649] Thus these requirements fit into the issuer's obligations to disclose its annual and periodical report as discussed in Chapter 2.

Secondly, it regulates the procedures, by which proxy solicitations are conducted. SEA'34 §14(a) however, does, not regulate substantive elements of shareholder voting.[650] The extent to which the SEC proxy rules go beyond disclosure relate mainly to the procedures by which the proxies are to be prepared, solicited and used. For example, SEC Rule 14a-4 restricts management's use of discretionary power to cast votes obtained by a proxy solicitation. Rule 14a-7 requires management cooperation in transmitting an insurgent's proxy materi-

646 See Stephen M. Bainbridge, 'The Scope of the SEC's Authority over Shareholder Voting Rights', *UCLA School of Law Research Paper No. 07-16*, May 2007., p. 1. Regulation of the proxy process is a core function of the Commission and one of the original responsibilities assigned to the Commission upon its creation in the SEA'34. When Congress charged the Commission with regulating the proxy process, it created a federal role in vindicating shareholders' state law rights. The federal interests include the importance of fair corporate suffrage and the prevention of abuses that would frustrate the free exercise of shareholders' voting rights. At the same time, however, Congress also recognized the traditional role of state corporation law, particularly with respect to the board's powers to manage the company's affairs. Briefing Paper: Roundtable on the Federal Proxy Rules and State Corporation Law (May 7, 2007), available at <http://www.sec.gov/spotlight/proxyprocess/proxybriefing050707.htm>.

647 See generally 17 C.F.R. § 240.14a-3. Even if the company is not soliciting proxies it still must provide shareholders with information prior to a meeting. 17 C.F.R. § 240.14c-2.

648 Once a proxy is solicited every 'solicitee' has to be provided with a written proxy statement which has to the disclosure rules. This statement has be approved by the SEC before it may be send to the shareholders. One exception is when the solicitation is done to less then 10 shareholders and the solicitation is not the initiative of the corporation itself, Rule 14a-2 (b), 17 C.F.R. § 240.14 a-2 (b) (1) (1990).

649 1) Quantitative and qualitative disclosures about mark risk required since 1997 by Regulation S-K Item 305; 2) A brief description of the business done by the registrant and its subsidiaries during the most recent fiscal year as well as industry segment data; 3) Information concerning each of the registrant's directors and executive officers; 4) The market price of and dividends on the registrants' common equity, together with related security holder matters. Unless the report itself satisfies Form 10-K, either the report or the proxy statement must contain an undertaking to supply a copy of the 10-K report.

650 See 2nd District Court in Business Rountable.

als to shareholders. SEC Rule 14a-8 requires management to include qualified shareholder proposals in the corporation's proxy statement at the firm's expense (see § 3.4).[651]

These observed goals are reflected in the legislative history of the Exchange Act and its § 14 (a) (proxy rules). Historically, proxy voting was used frequently in the US. However, in practice investors were often not fully informed or actually deceived when their votes were solicited. The intent of § 14(a) SEA'34 and SEC's Rules thereunder is to 'protect investors from promiscuous solicitation of their proxies'.[652] These rules are enforced in the SEA'34 itself, private enforcement playing a particular role in enforcing these rules; any misleading statements under the federal proxy rules § 14 (a) are covered under the general securities fraud action (§ 10-b and SEC Rule 10-b-5). (see par. 2.6 and 2.7 for public (SEC!) and private enforcement.)

Summarising, the focus of US proxy voting is on enabling shareholders to make effective use (by disclosure) of whatever voting rights they possess by virtue of state law. In its concept, the federal securities rules take no stand in the debate on improving shareholder democracy, however, as observed improving shareholder democracy has been on the regulatory agenda of the SEC for years. Also listing rules (such as NYSE, NASDAQ) regulate corporate governance items, but their enforcement differs substantially as will be discussed in the next paragraph.

3.6.2 Proxy voting and corporate governance

Proxy voting is closely connected with 'corporate democracy' and corporate governance. The EU Shareholders Rights Directive also aims at shareholder control as part of sound corporate governance facilitated by a system of proxy voting. Also in the Netherlands, the introduction of a record date facilitating a system of proxy voting and Principle IV DCGC seems to be part of or have been part of the tide to 'improve' shareholders democracy.

In the US, the system of proxy voting was enacted as part of the overall objective of the Securities Exchange Act '34. The Securities Exchange Act, as discussed above, does not address corporate governance as such. Instead, its focus is on trading of securities and securities pricing in the securities markets. Virtually all of its provisions address such matters as the

651 Stephen M. Bainbridge, 'The Scope of the SEC's Authority over Shareholder Voting Rights', *UCLA School of Law Research Paper No. 07-16*, May 2007.

652 Id. at 77. The Senate Committee's report on stock exchange practices likewise focused on disclosure concerns. It noted that management frequently asked shareholders to grant proxies without explanation of the matters to be acted upon. S. Rep. No. 1455, supra note 30, at 74. See also S. Rep. No. 792, 73d Cong., 2d Sess. 12 (1934) ("Too often proxies are solicited without explanation to the shareholder of the real nature of the questions for which authority to cast his vote is sought."). The report emphasised the need for adequate shareholder knowledge about both the company's financial position and matters of policy. S. Rep. No. 1455, supra note 30, at 74. Finally, in describing the intent of § 14(a), the report contemplated that the SEC's rules thereunder would "protect investors from promiscuous solicitation of their proxies." Congress was made aware of these concerns in some detail. Thomas Corcoran, for example, told the House Committee that "[p]roxies, as solicitations are made now, are a joke." He testified at length about the lack of disclosure provided to shareholders and abuses of the proxy solicitation process. In answer to a question as to how these abuses could be prevented, he referred solely to the need for better disclosures. Similarly, in a brief supporting the Exchange Act's constitutionality, Corcoran and Benjamin Cohen stated that the proxy provisions were "designed to make available to the investor reasonable information regarding the possibility of control of the corporation ...."

production and distribution of information[653] about issuers and their securities, the flow of funds in the market, and the basic structure of the market.[654] The legislative history of the SEA'34[655] clarifies that its purpose is not to regulate topics of corporate governance, which remains the realm of state corporate law. This also applies to the broad regulatory power giving to the SEC under the SEA'34 and also § 14 (a);[656] the SEC has no authority over the substance of corporate governance.[657] An attempt by the SEC to regulate the substance of voting rights (SEC Rule 19a-4, prohibiting the use of non-voting stock) arguing that the Commission has the power to do so under § 14 (a) SEA'34 (proxy voting), was immediately and successfully contested in the case of the *Business Roundtable v. the SEC*.
In striking down SEC Rule 19c-4, the DC Circuit closely tied the question of the scope of the SEC's authority over voting rights to the broader question of the SEC's authority over the substance of corporate governance generally. As the court observed: *"nothing in the legislative history comes near to saying: 'The purposes of this act, although they generally will*

653 See e.g. Federal Licensing of Corporations: Hearings Before the Senate Judiciary Comm., 75th Cong., 1st & 3d Sess. (1937 & 1938), at one of the hearings, the SEC's Assistant Director of Registration was asked whether the federal securities laws prohibited the use of nonvoting stock. He replied that "they only require that an adequate disclosure of the material facts concerning that structure be made."

654 Stephen M. Bainbridge, 'The Scope of the SEC's Authority over Shareholder Voting Rights', *UCLA School of Law Research Paper No. 07-16*, May 2007, p. 10 and further for an extensive overview of the legislative history of the SEA'34 and of § 14 (a) SEA'34 which indicates that congress did *not* have any intention to regulate corporate governance also not under rules on proxy voting and broad regulatory power given to the SEC. Important is the remark on page 10, Congress' inaction, accordingly, should be read as leaving voting rights in the hands of the states and the exchanges, especially when considered in light of the repeated congressional rejections of proposals to federalize corporate law. See also: Disclosure was the chief vehicle by which the Act's drafters intended to regulate the markets. Brandeis' famous dictum – "Sunlight is . . . the best of disinfectants; electric light the most efficient policeman" – was well accepted by the 1930s; indeed, it was the basic concept around which the federal securities laws were ultimately drafted. Because state securities laws could not effectively assure full disclosure, federal intervention was widely accepted as essential to maintaining the national capital markets.

655 See SEA'34, Pub. L. No. 73-291, § 2, 48 Stat. 881, 881-82 (1934); S. Rep. No. 792, 73d Cong., 2d Sess. 3 (1934) (need to control excessive stock market speculation that had "brought in its train social and economic evils which have affected the security and prosperity of the entire country."); Cong. Rec. 7921-22 (1934) (Rep. Mapes) (the Act had two objectives: to prevent excessive speculation and to provide a fair and honest market for securities transactions).

656 Brief for Respondent at 13, *Business Roundtable v. SEC*, 905 F.2d 406 (D.C. Cir. 1990) [hereinafter SEC Brief]. The legislative history of § 14(a) is relatively sparse, in large part because the controversy over federal proxy regulation was resolved early in the legislative process. As originally introduced, the proxy provision mandated substantial disclosures and gave the SEC authority to adopt additional disclosure requirements. H.R.7852, 73d Cong., 2d Sess. § 13(a) (1934). The proposal met with substantial criticism. In redrafting § 14(a) in response to these criticisms, Congress did what it often does when it has a tough problem to solve: it told somebody else to solve it. In effect, the Act simply made it unlawful to solicit proxies "in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors." SEA'34, Pub. L. No. 73-291, § 14(a), 48 Stat.881, 895 (1934).

657 Stephen M. Bainbridge, 'The Scope of the SEC's Authority over Shareholder Voting Rights', *UCLA School of Law Research Paper No. 07-16*, May 2007, concludes after extensive reading of the legislative history of the SEA'34: "But surely the Congress that repeatedly denied any intent to regiment corporate management, and later repeatedly rejected proposals to federalize corporate law, did not intend to sneak those powers back into the bill through the back door by authorizing the SEC to adopt corporate governance rules. More important for present purposes, however, there is no reason to believe that Congress intended to carve out the substance of voting rights as a single exception to this general rule."

not involve the Commission in corporate governance, do include preservation of the one share/ one vote principle.' And even [if any did] we doubt that such a statement in the legislative history could support a special and anomalous exception to the Act's otherwise intelligible conceptual line excluding the Commission from corporate governance. Accordingly, it is appropriate to devote some attention to the evidence supporting that 'conceptual line'."[658] Compare also *Santa Fe Industries v. Green*[659] and *CTS Corp. v. Dynamics Corp*[660], in which the US Supreme Court confirms the view that the state is the principal regulator of corporate governance. Federal law is seen as placing a gloss on the underlying background of state corporate law, but not as replacing it.[661]

§ 14 (a) SEA'34 states that SEA confines itself to disclosure and procedural rules as seen above. Of course, some of these rules affect shareholder voting, but only with a narrow affect on corporate governance. However, SRO, like NYSE and NASDAQ, disseminate, under pressure of the SEC, listing rules that the SEC is not allowed to promulgate under the rule of *Business Roundtable*. However these listing rules are enforced totally differently to 'enforcement' of corporate governance codes in the EU. This will be analysed in chapter 4. *In the EU* and several Member States, no comparable system of proxy voting as in the US has evolved so far. The EU Shareholder Rights Directive does not result in a EU federal system of proxy voting, once implemented it should only eliminate national barriers to voting as it facilitates cross-border voting in the EU and strengthening of shareholder rights/position.[662] In the

658 Other judicial interpretations of § 14 are also consistent with the notion that § 14 (a) SEA '34 was directed at assuring full disclosure and a fair opportunity to exercise corporate voting rights (of course, these decisions were rendered in cases in which it was those aspects of the rules that were at issue). E.g., *Mills v. Electric Auto-Lite Co.*, 396 U.S. 375, 381 (1970); *Greater Iowa Corp. v. McLendon*, 378 F.2d 783, 795 (8th Cir. 1967*); Dann v. Studebaker-Packard Corp.*, 288 F.2d 201, 208 (6th Cir. 1961); *SEC v. Transamerica Corp*., 163 F.2d 511, 518 (3d Cir. 1947), cert. denied, 332 U.S. 847 (1948); *NUI Corp. v. Kimmelman*, 593 F. Supp. 1457, 1469 (D.N.J. 1984), rev'd, 765 F.2d 399 (3d Cir. 1985); *Freedman v. Barrow*, 427 F. Supp. 1129, 1145 (S.D.N.Y. 1976); *Leighton v. American Telephone & Telegraph Co.*, 397 F. Supp. 133, 138 (S.D.N.Y. 1975); *Studebaker Corp. v. Allied Products Corp.*, 256 F. Supp. 173, 188-89 (W.D. Mich. 1966).

659 In *Santa Fe Industries v. Green*, the Supreme Court applied the brakes to efforts to give SEC Rule 10b-5 an increasingly expansive reading that in time might have led to a federal common law of corporations. The Court did so by holding that the fundamental purpose of the Securities Exchange Act is to assure full disclosure. Once complete disclosure is made, the transaction's fairness and terms do not become issues under federal law, instead they are a matter for state corporate law. The Court's analysis was driven by a concern that a broader view of the Act's purposes would result in federalizing much of state corporate law, overriding well-established state policies of corporate regulation.

660 In *CTS Corp. v. Dynamics Corp*., the Supreme Court again drew a sharp line between the state and federal role, this time with specific application to the problem at hand. The Court recognized that states have a legitimate interest in defining the attributes of their corporations and protecting shareholders of their corporations. Specifically, the Court strongly indicated that the substance of corporate voting rights is solely a matter of state concern: "No principle of corporation law and practice is more firmly established than a State's authority to regulate domestic corporations, including the authority to define the voting rights of shareholders."

661 Stephen M. Bainbridge, 'The Scope of the SEC's Authority over Shareholder Voting Rights', *UCLA School of Law Research Paper No. 07-16*, May 2007, p. 17, absent a clear expression of congressional intent, the Court has been reluctant to federalize questions traditionally within the state sphere. Given the absence of any indication of congressional intent to pre-empt state laws governing shareholder voting rights, it is therefore unlikely that the Supreme Court would support an expansive view of the SEC's authority to regulate the substance of shareholder voting rights. To the contrary, it seems far more likely that the Court would embrace the line drawn by *Business Roundtable*.

662 Luca Enriques and Matteo Gatti, 'The Uneasy Case for Topdown Corporate Law Harmonization in the European Union', *27 U. Pa. Int'l Econ. L. 939*, 2006, have argued that there were insufficient reasons

examined MS, the proxy rules are partly regulated in listing rules (see the UK) and/or corporate law (UK/NL/GER) and soft law (corporate governance codes, NL).

3.6.3 EU Shareholder Rights Directive and the concept of proxy voting

In the EU, no system of federal proxy voting has developed so far. The EU Shareholders Rights Directive aims to facilitate shareholder voting focusing in particular on problems with cross-border voting (Member States should implement as of 3 August 2009, the Netherlands has not implemented yet).

The Shareholder Rights Directive is a mix of principles, mandatory rules and rules that provide companies with options. The Directive harmonises certain shareholder rights.[663] The key provisions include: 1) equal treatment of shareholders as to participation and voting in the general meeting, a requirement also enacted in the Transparency Directive; 2) required notice of general meeting of at least 30 days and certain required information;[664] 3) the right to put items on the agenda of the general meeting and table draft resolutions;[665] 4) removal of requirements of any blocking mechanism such as share deposits that restrict shareholder participation in the general meeting and a record date, mandatory for an issuer with bearer shares;[666] 5) the right of shareholders to ask questions on agenda items and the duty to respond thereto;[667] 6) allowing and facilitating proxy voting; the Transparency Directive also entitles shareholders to exercise voting rights by proxy. In particular, the Transparency

to justify the Voting Rights Directive. They see the Voting Rights Directive as having two goals – the removal of national barriers to voting and strengthening shareholder right and that the former is the only legitimate goal for the EU. But they think that Voting Rights Directive goes beyond what was needed to accomplish that goal, see p. 983-91.

663 Lower House, 2008–2009, 31 746, no. 3 Explanatory Note (explanation proposal of Bill 'Shareholder Rights Directive), p.1.

664 The information according to art. 5 of the Voting Rights Directive includes "(a) a precise indication of the place, time and draft agenda of the meeting; (b) a clear and precise description of the procedures that shareholders must comply with in order to be able to participate and to cast their vote in the general meeting, including the applicable record date; (c) a clear and precise description of the available means by which shareholders can participate in the general meeting and cast *their* vote. Alternatively, it may indicate where such information may be obtained; (d) an indication where and how the full, unabridged text of the resolutions and the documents intended to be submitted to the general meeting for approval may be obtained." In addition companies must post on their Internet sites (a) the meeting notice (b) the total number of shares and voting rights; (c) the texts of the resolutions and the documents for the meeting; (d) the forms to be used to vote by correspondence and by proxy (or where and how the forms can be obtained). *Id.*, art. 15, at 13 (publishing post meeting information on the company's internet site within 15 days the voting results). See also Dirk Zetzsche, 'Virtual Shareholder Meetings and the European Shareholder Rights Directive – Challenges and Opportunities', *CBC-RPS No. 0029,* June 2007 see also Arthur R. Pinto, The European Union's Shareholder Voting Rights Directive from an American Perspective: Some Comparisons and Observations, Fordham International Law Journal, Vol. 32, 2008, p. 20. E.g. SEC Rule 14a-16 provides for a proxy statement at least 40 days before a meeting while Del. Gen. Corp. Law § 222(b) indicates notice of not less than 10 or more than 60 days. 17 C.F.R. § 240.14a-16; Del. Code Ann. tit. 8, § 222(b).

665 Art. 6 Shareholder Rights Dir. indicates that Member States can require a minimum stake in the share capital of the issuer but such minimum shall not exceed 5% or a nominal value of EUR 10 million, whichever is the lower.

666 See art. 7 Shareholder Rights Directive.

667 In 2005 amendments to the German Stock Corporation Act allows German companies to provide in their articles or by laws to authorize the chairman of the meeting to restrict a shareholder's right to speak and ask questions. Michael Arnold and Andreas Wolfle, 'Defining the rights of shareholders', *International Financial Law Review*, May 2006, See Arthur R. Pinto, 'The European Union's Shareholder

Directive requires that "issuers make available electronic or paper proxy forms to each person entitled to vote" (art. 17 Transparency Directive[668]). MS can restrict the exercise of shareholder rights through proxy holders only for the purpose addressing potential conflict of interest, for example if the proxy holder is a controlling shareholder of the company (art. 10 (3) (i) Shareholder Rights Directive or a member of the administrative, management or supervisory body of the company (art. 10 (3) (ii) Shareholder Rights Directive). MS in doing so shall not impose any requirements other than listed in art. 10(3) (a)-(c), (a) states that MS may prescribe that the proxy holder disclose certain specified facts which may be relevant for the shareholders in assessing any risk that the proxy holder might pursue any interest other than the interest of the shareholder. As analysed in the previous paragraph, the purpose of addressing potential conflicts of interest when shareholders are asked for their (proxy) vote is one of the aims of US federal proxy rules evidenced by its legislative history, and one of the reasons for extensive disclosure duties for proxy solicitation individually and through securities accounts.[669]
The Directive further attempts to deal with the potential of the internet and thus one of its goals was to "remove all legal obstacles to electronic participation in general meetings".[670] In concept, this Directive follows the Commission's plan of May 2003 ('Modernising Company Law and enhancing Corporate Governance in the European Union, A Plan to Move Forward' ('CLAP')), namely corporate governance[671] [672]. As already observed in Chapter 1, this plan follows the HLG Final Report of 4 November 2002, which identified shareholder protection as a key issue for ensuring good corporate governance, with particular emphasis on the elimi-

Voting Rights Directive from an American Perspective: Some Comparisons and observations', *Fordham International Law Journal,* Vol. 32, 2008, p.21.

668 Art. 17 TD, with respect to shareholder information, the TD also requires, in particular, information about the place, time and agenda of shareholder meetings, and the rights of holders to participate in meetings. MS must allow the use of electronic means for the purposes of conveying information to shareholders if the shareholders so decide.

669 Member States can restrict proxy holders who may be connected to the company.

670 Dirk Zetzsche, 'Virtual Shareholder Meetings and the European Shareholder Rights Directive – Challenges and Opportunities', *CBC-RPS No. 0029,* June 2007 and Arthur R. Pinto, 'The European Union's Shareholder Voting Rights Directive from an American Perspective: Some Comparisons and observations', *Fordham International Law Journal,* Vol. 32, 2008, p.21.

671 A number of rationales were given for CLAP including increased cross-border operations activities requires common EU company law mechanisms to facilitate freedom of establishment and cross-border restructuring; integration of capital markets and the need to have equivalent corporate governance frameworks; maximisation of the benefits of modern technologies on information and communication technology; the forthcoming enlargement of the EU with 10 new Member States; recent financial scandals and the needs and demands of investors for protection from "shoddy, greedy and occasionally fraudulent corporate behaviour." CLAP § 1.2. CLAP also discussed other shareholder rights that should be harmonised such as a right to appoint a special auditor and a duty of institutional investors to disclose their investment and voting policies, which may be dealt with at a later time. *See* Baums, 'European Company Law Beyond the 2003 Action Plan', *ECGI-Law Working Paper No. 81,* 2007.

672 The EU has implemented some other provisions from CLAP involving corporate governance-related issues with three recommendations (which are not binding) and four directives, which have been enacted. The three recommendations deal with auditors' independence, remuneration of directors, and the role of non-executive directors. The four directives enacted include the Directive on Statutory Audit, a revision of the Directive on Legal Capital, the Directive on Shareholders' Rights and the Directive on Cross-Border Mergers. However also the 4/7th Directives were amended, i.e. corporate governance statement and collective responsibility for the board.

nation of obstacles to cross-border activities.[673] The EU Shareholder Rights Directive fits in the above mentioned regulatory agenda by aiming at amongst other things the promotion of good corporate governance through shareholder participation in voting.[674] Its Preamble (no.3) states that 'holders of shares carrying voting rights should be able to exercise those right given that they are reflected in the price that has to be paid at the acquisition of the shares.[675] Furthermore, the Preamble states that 'effective shareholder *control* is a prerequisite to sound corporate governance and should, therefore, be facilitated and encouraged'. This Directive therefore, as do other initiatives of the Commission, fits into the tradition of protecting the shareholder through corporate law as we have seen in part II by amending EU corporate Directives (4/7th and 8th) and Recommendations (e.g. on NED). Conceptually this Directive takes a different route than the US proxy system regulated mainly in the SEA'34. The EU Shareholder Directive aims at better monitoring by shareholders and does not seem to absorb the evolved system of EU securities regulation and the protection of the investor in the market; as to disclosure requirements it focuses on providing shareholders with, for example, notice of the meeting (art. 5) and procedure of voting (art. 7).[676] It appears to follow the path of harmonising *corporate* law rather than extending the body of EU securities law.

673 Report of the High Level Group of Company Law Experts on a Modern Regulatory Framework for Company Law in Europe (Nov. 4, 2002) (Brussels): <http://ec.europa.eu/internal_market/company/docs/modern/report>, The report indicates a number of specific obstacles concerning the entitlement to vote, admission to general meetings, information and documentation, and shareholders' rights at the general meeting. The Winter Group also recommended that the Commission, as a matter of priority, set up a specific project to build a regulatory framework for shareholder information, communication and decision making that would facilitate the participation of shareholders across the EU and, where possible, outside the EU, in the governance of European listed companies

674 Arthur R. Pinto, 'The European Union's Shareholder Voting Rights Directive from an American Perspective: Some Comparisons and observations', *Fordham International Law Journal,* Vol. 32, 2008; There are a number of different reasons behind this directive. In much of Europe there is no long tradition of easy proxy voting directly by shareholders with a variety of constraints, and the voting rights directive may enhance that voting. There was the promotion of good corporate governance through shareholder participation in voting, the protection of EU shareholders who do not reside in the home country where their company resides, the protection of small individual shareholders, the concern that increased ownership by foreign investors could create firms with passive investors, the recognition of increased cross border investing and the importance of integrated markets. *see* Annex to the Proposal for a Directive of the European Parliament and of the Council on the Exercise of Voting Rights by Shareholders of Companies Having Their Registered Office in a Member State and Whose Shares are Admitted to Trading on a Regulated Market and Amending Directive 2004/109/EC, Eur. Parl.Doc. (COM 2005) 685, *available at* <http://ec.europa.eu/internal_market/company/docs/shareholders/comm_native_sec_2006_0181_en.pdf>(hereinafter "Annex").

675 However the share price of restricted or non-voting shares in most instances will have incorporated the fact exercising a voice through voting is restricted. If one extends this line of reasoning also protective devices in case of a hostile takeover by which shareholder voice is neutralised for a period in time are not allowed.

676 According to the Preamble of the Shareholder Rights Directive, "The existing Community legislation is not sufficient to achieve this objective. Directive 2001/34/EC of the European Parliament and of the Council of 28 May 2001 on the admission of securities to official stock exchange listing and on information to be published on those securities focuses on the information issuers have to disclose to the market and accordingly does not deal with the shareholder voting process itself. Moreover, Directive 2004/109/EC of the European Parliament and of the Council of 15 December 2004 on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market imposes on issuers an obligation to make available certain information and documents relevant to general meetings, but such information and documents are to be made available in the issuer's home Member State. Therefore, certain minimum standards should

3.6.4 Proxy voting in the MS: UK, Ger and NL

Proxy voting in the UK is regulated by statutory provisions in the secs. 324-331 UK CA 2006; these can be characterised as procedural rules. Formerly, UK proxy voting was (since 1948) mainly regulated in the articles of association which, in practice, allowed the board to entrench their position. It had become common practice for boards to send proxy forms in their own favour with the notice of the meeting and for these to be stamped and addressed at the company's expense.[677] For this lack of shareholder democracy the LSE, however, required that listed companies should send out 'two-way' proxies, i.e. forms which enabled members to direct the proxy whether to vote for or against any resolution. The FSA's listing rules currently require 'three-way' proxies (for, against or abstain) (LR 9.3.6.).[678]

Sec. 324 (1) UK CA 2006 states that any member is entitled to appoint another person (whether a member of the company or not) as his proxy to attend, speak and vote instead of himself at a meeting of the company. Sec. 324 (2) UK CA 2006 provides that the member may appoint more than one proxy, provided each proxy is appointed to exercise rights attached to different shares. Sec. 325 UK CA 2006 states that members must be informed of their statutory rights to attend, speak and vote by proxy in the notice convening the meeting; sec. 236 (1) if proxies are solicited at the company's expense, the invitation must be sent to all members entitled to attend and vote; sec. 327 the articles may not require that proxy forms must be lodged more than 48 hours before a meeting or adjourned meeting.[679]

The UK CC does not address proxy voting. The aforementioned provisions does not really influence the tactical advantages of the directors. They still strike the first blow and their solicitation of proxy votes is likely to meet with a substantial response before the opposition is able to react.[680] However, once opposition is aroused, members may be persuaded to cancel their proxies (sec. 330 UK CA 2006).

Proxy voting in Germany: § 134 (3) AktG[681] makes proxy voting (including by electronic means (§ 126 BGB)) possible. See also sec. 2.3.3 GGCC which requires the company to assist the

be introduced with a view to protecting investors and promoting the smooth and effective exercise of shareholder rights attaching to voting shares."

677 Gower and Davies, Principles of Modern Company Law, Sweet & Maxwell, London: 2008 p. 456.

678 The Jenkins Committee advised to makes this requirement statutory law. Proxy voting is also regulated in the FSA Listing rules (9.3.6 'proxy forms' and 9.3.7 'proxy forms for re-election of retiring directors). These rules are an addition to the proxy rules in UK CA 2006, they do not relate to disclosure (procedural rule attaching voting rights).

679 Gower and Davies, Principles of Modern Company Law, Sweet & Maxwell, London: 2008, p. 487

680 Gower and Davies, Principles of Modern Company Law, Sweet & Maxwell, London: 2008, p. 457, actually describing what happens when management is allowed and in practice is soliciting proxies of their shareholders: 'Even if their proxies are in "two-way" form, many members will complete and lodge them (encouraged by the fact that postage is prepaid). Most two-way proxies provide that if neither "for" nor "against" is deleted the proxy will be used as the proxy thinks fit, e.g. as the board wish. LR 9.3.6 requires this to be expressly stated: "After hearing but one side of the case, and only the most intelligent or obstinate are likely to withstand the impact of the, as yet, un contradicted assertions of the directors." The Shareholder Rights Directive allows restriction of aforementioned practice by allowing the MS (amongst others) to restrict or exclude the exercise of shareholder rights through proxy holders without specific voting instructions for each resolution in respect of which the proxy holder is to vote on behalf of the shareholder.

681 § 134 (1) AktG regulate one share one vote.

shareholders in the use of proxies.[682] The UMAG introduced a record date; shareholders who hold shares in their bank account under their own name at the relevant record date 21 days prior to the meeting are entitled to exercise their shareholder rights at the meeting (123 (2) AktG).[683] The traditional important position of German banks[684] in the system of corporate governance has to be taken into account.[685] Because of the traditional use of bearer shares in Germany and their deposition with banks, as well as the generally strong position of the banking sector, special attention is paid to the exercise of the vote by banks on behalf of the shareholders.[686] § 135 (1), (5) AktG and § 128 (2) AktG for example address potential conflict of banks in voting.[687] Because of a number of developments one of them being the introduction of the management proxy in Germany banks are losing their influence. Since 2001, it is explicitly admissible for a proxy to be given to the management, § 134 (3) AktG.[688] US-style (securities law) proxy rules requiring information under the supervision of a federal authority have not been introduced so far. However, a management proxy can only be used if accompanied by binding instructions (§ 135 (1) AktG), as is allowed under art. 10 (3)

682 Sec. 2.3.3 GCGC The company shall facilitate the personal exercising of shareholders' voting rights. The company shall also assist the shareholders in the use of postal votes and proxies. The Management Board shall arrange for the appointment of a representative to exercise shareholders' voting rights in accordance with instructions; this representative should also be reachable during the General Meeting.

683 Ulrich Noack and Dirk Zetzsche, 'Germany's Corporate and Financial Law 2007: (Getting) Ready for Competition', *Heinrich-Heine-University Dusseldorf-CBC-RPS 0028,* June 2007, p. 17, the UMAG facilitates also electronic proxy voting and other forms of electronic voting *in absentia*, since the procedure for identifying and authorizing shareholders may rely entirely on electronic. In terms of shareholder representation at the meeting this reform is a success; the implementation of the record date system raised average turn-outs at shareholder meetings in the 30 largest corporations by app. 4 percent.

684 Spindler, in K.Schmidt/Lutter (eds.), Kommentar Aktiengesetz, 2008, § 134 (3): "Das Depotstimmrecht hat lange zeit zu einer besonderen Form der Corporate Governance geführt, die einhergehend mit Überkreuzverflechtungen und Fremdfinanzierungen zur einer Art finanz- und bankzentriertter Unternehehmenskontrolle geführt hat, die ert in Rahmen der zunehmenden Globalisierung und Beteutung der Kapitalmärkte aufgebrochen wurde."

685 Udo C. Braendle, 'Shareholder Protection in the USA and Germany – "Law and Finance" Revisisted', *German Law Journal*, Vol. 07 No. 03, 2006. Traditionally the German system was characterised by the mechanism of depositary proxy votes practices of banks. Proxy voting by banks is available after the assignment of legitimation to a bank. This is a legal disposition of the voting rights without transferring the ownership. The bank receives the right to exercise the vote either on behalf of the owner if he gives clear instructions or on its own behalf if these instructions are missing. In the latter case, banks are not obliged to disclose the owner of the shares. Cf. also Seibert, 'Die Stimmrechtsrechtsausübung in deutschen Aktiengeselschaften – ein Bericht an den Deutschen Bundestag', *AG* 2004, 529.

686 Mathias M. Siems, *Convergence in Shareholder Law*, New York: Cambridge University Press, 2008, p. 105.

687 Theodor Baums and Philip von Randow, 'Der Markt für Stimmrechtsvertreter', *AG* 1995, 145.

688 134 (3) AktG, as amended by Gesetz zur Namensaktie und zur Erleichterung der Stimmrechtsausübung (NaStraG) of 18.01.2001, BGBI. I 123.Spindler, , in K.Schmidt/Lutter (eds.), AktG, 2008, § 134 (3), Rz. 55. Cf. also Lenz, Die gesellschaftsbenannte Stimmrechtsvertretung (Proxy-Vertretung) in der hauptversammlung der deutschen publikums-AG, 2005, S. 209, 216. Whether the German BoM can vote by proxy for its shareholders as in the US system is not certain. Spindler, K.Schmidt/Lutter (eds.), AktG, 2008, § 134 (3), Rz. 55 doubts whether a US-style proxy voting system, in which management is in control has been enabled by § 134 (3). Cf. also Mathias M. Siems, *Convergence in Shareholder Law*, New York: Cambridge University Press, 2008, p. 105.

Shareholder Rights Directive (see the US system).[689] Notably, the shareholder's forum,[690] as introduced by the UMAG (§ 127a AktG), facilitates communication between shareholders, which should reduce shareholders' collective action problems.[691]

Proxy voting in the Netherlands is allowed under art. 2:117 NCC.[692] A record date, underpinning a system of proxy voting, was introduced by art. 2:119 NCC.[693] This rule aims at better communication between the firm and its shareholders and has its origins in the Dutch corporate governance debate around 2002/2003 on the question of how to strengthen the check and balances in the public corporation.[694] The alleged weak position of shareholders in Dutch listed public corporations was perceived as one of the causes of the 2000/2001 corporate scandals, see par. 2. Also the DCGC of 2009 still, at least in part, focuses on strengthening the position of shareholders. Principle IV DCGC apparently combines the procedural/technical possibility by mandating the possibility to vote by proxy ("Good corporate governance requires the fully-fledged participation of shareholders in the decision-making in the general meeting. It is in the interest of the company that as many shareholders as possible take part in the decision making in the general meeting. The company shall, in so far as possible, give shareholders the opportunity to vote by proxy and to communicate with all other shareholders".) The substance of shareholders' rights, namely 'to exert such influence on the policy of the management board and the supervisory board of the company that it may play a

689 Ulrich Noack, 'Stimmrechtsvertretung in der Hauptversammlung nach NaStraG', *ZIP 57*, 2001.Cf. also Mathias M. Siems, *Convergence in Shareholder Law*, New York: Cambridge University Press, 2008, p. 106.

690 Ulrich Noack and Dirk Zetzsche, 'Germany's Corporate and Financial Law 2007: (Getting) Ready for Competition', *Heinrich-Heine-University Dusseldorf-CBC-RPS 0028,* June 2007. On this website shareholders may give notice of their intent to induce the above pre-procedure for a particular shareholder suit; initiate a special investigation of certain managerial conduct; propose a vote on a specific issue in shareholder meetings, or call a shareholder meeting on behalf of the corporation. As far as we know, this institution is unique.

691 Ulrich Noack and Dirk Zetzsche, 'Germany's Corporate and Financial Law 2007: (Getting) Ready for Competition', *Heinrich-Heine-University Dusseldorf-CBC-RPS 0028,* June 2007. Apparently only a few shareholders have used this electronic forum. One of the reasons is that securities law claims, where collective action problems are probably at their most severe, are not yet in the catalogue of rights which may be exercised over the shareholders' forum.

692 C.A. Schwarz, *Stemrechtloze aandelen*, Maastricht University: Oratie: 1990, J.J.M. Maeijer, *Asser 2-III Vertegenwoordiging en Rechtspersoon, De Naamloze en de Besloten Vennootschap*, Deventer: Tjeenk Willink 2000, nr. 282. Cf. Also Raaijmakers, *Ondernemingsrecht, Pitlo/Raaijmakers,* Deventer: Kluwer 2006, p. 385. Cf. also J. W. Winter, *Grensoverschrijdend stemmen*, Erasmus Universiteit Rotterdam: Oratie 2000 and J.W. Winter en M. van Ginneken, 'Stemmen op afstand van dichtbij bekeken', in: M. Raaijmakers, R.van Rooy en A. tervoort (Eds.), *Ongebonden recht bedrijven*, Deventer: Kluwer 2001, p. 325-342, on inter alia ultimate holding issue.

693 The right for shareholders to ask questions during a meeting and to make draft resolutions were already law in the Netherlands.

694 Explanatory Memorandum, Parliamentary Papers II, 2003/2004, 26 668, No. 3, p.1, entering a record date was considered necessary because the listed company has listed bearer shares. Therefore the company has no opportunity at the time of the general meeting to determine who its shareholders are. This makes it difficult to check the validity of the proxies granted by the shareholders. A proxy at a general meeting is only valid if the shareholders at that time are still shareholder. To ensure this the shares had to be blocked during the time the proxy has been given, Schwarz, article 119, note 3. The record date prevents the aformentioned "blocking" of shares because at the time of the record date the then registered shareholders at the GMS counts as those entitled to vote even though between the day of registration and the date of the GMS the share(s) are transferred, Explanatory Memorandum, Parliamentary Papers II, 1998/1999, 26 668, No 3, p. 1-6).

fully-fledged role in the system of checks and balances in the company' (Principle IV DCGC) entails a totally different route than under the US investor market-oriented proxy system.
The Dutch Bill to implement the Shareholder Rights Directive[695]can be regarded as continuing the corporate governance debate that re-started in 2002/2003. The explanatory notes to the Bill state that the Directive aims to strengthen the exercise of rights of shareholder in listed public companies and to resolve problems connected to cross-border voting.[696] The NCC will be amended (see also the proposed amendment considering shareholders' right to put items on the agenda as analysed under par. 3.4.2[697]) and some new articles introduced, such as art. 2:113 (6) NCC requiring listed public corporations to issue the convocation of the general meeting through electronic means which will be directly assessable upon the meeting that will take place (art. 5 (2) Shareholder Rights Directive) or art. 117 (3) NCC, implementing art. 7 (1) (a): participation/voting by shareholders in the general meeting shall not be subject to any requirement that his shares be deposited with another natural or legal person before the general meeting. These procedural rules, such as the introduction of a single record date, facilitate shareholder voting.[698]
Art. 10 (3) Shareholder Rights Directive provides MS the *option* to restrict the exercise of shareholders' rights through a proxy holder only for the purpose of addressing potential conflict of interest. Such a conflict of interest is potentially present when the proxy holder is, for example, a member of the administrative, management or supervisory body of the company (art. 10 (3) (ii) Shareholder Rights Directive). This default rule will not be executed by the Bill; according to the proposal there is no reason to make a special regulation on this topic, because Dutch law offers enough possibilities to tackle possible abuse by the proxy holder. For example under Dutch law a proxy can be rescinded under art. 3:40 NCC because of breach of the public order or mandatory law. Solicitation of proxies by the board (BoM/SB) is seemingly not prohibited. Nonetheless, extensive disclosure rules to prevent abusive

695 Lower House, 2008-2009, 31 746, nr 2, "Wetsvoorstel Wijziging Boek 2 en Wft ter uitvoering Richtlijn inzake aandeelhoudersrechten", a Proposal of Bill is pending with First Chamber of the Parliament. Simultaneously with this proposal of bill, a proposal of bill (Lower House 2008-2009, 32 014) following the advice of the Monitoring Committee Corporate Governance Code of May 30, 2007 is in preperation, that entails a regulation that enables a listed company to discover the identity of its shareholders.

696 The measures in the Directive to which the bill (31 746) is implemented, facilitate the participation of shareholders in decisions of the GMS.

697 Recently, cause of implementation of the Shareholders Rights, a proposal of Bill proposes two amendments to art. 2:114: 1 NCC) a request for putting an item on the agenda should state the grounds for putting it on the agenda, 2) abolishment of the corporation's right (art. 2:114a (1) NCC) to refuse to put an item on the agenda because of 'important interests of the corporation'. Consequently, the right of shareholders to put an item on the agenda seemingly will be strengthened; the discretion of the board to refuse an item proposed by the shareholder is affected. However, only subjects on which the GMS has a right to vote can be legally binding; putting other items as recommendations on the agenda combined with enforcement (elaborated hereafter) in practice can have binding force (ch. 4 will elaborate this item); de facto in practice the right to put also motions (see *Stork* and *ABNAMRO*) not belonging to the competence of the GMS to decide functions as an "instruction-right"of the GMS. However it also could be argued that the proposed amendment strengthens the position of the board. Under arts. 2:129/2:8 and ASMI the board has the discretion to refuse agenda items that do not belong to the competence of the GMS.

698 See p. 4 of the Explanatory Memorandum (31 746), on a record date and convocation of a GMS in case of protective measures according to art. 2:359 (b) NCC. According to art. 5 (1) of the Dir., the notice period for convocating a meeting in case of a take over will be set on 30 days for approving, if the art. of incorporation so determine, protective devices by the GMS.

solicitation, as in the US, are lacking under the Dutch system. Some of the prescribed rules of the Shareholders Rights Directive will be implemented in the Act on Financial Supervision (AFS).[699] For example rules related to the requirement to place information on the company's website (AFS chapter 5.1a).

3.5.5 Conclusions

If, how and on at what level (corporate or securities law) legal regimes have developed and are facilitating mechanisms and rules on proxy voting may influence the division of power within the corporation. US practice illustrates that a) incumbent management may use the proxy machinery to collect a decisive power to vote on proposals presented by the board to shareholders, b) the main focus is on appointment of members of the board (and incidental corporate reorganisations), c) that board proposals may be contested by means of a proxy fight and d) that solicitation of proxies is regarded and regulated as a 'market transaction' (through *securities law* disclosure not intruding the internal affairs of the corporation). The system is moulded into US securities regulation (securities acts/rules and *listing rules*) aiming at investor protection by disclosure.

As discussed, these proxy rules may also fit into a tradition of corporate/governance aiming at 'shareholder democracy' and voice within issuers. Conceptually this makes a difference. The former mainly underscores the monitoring function of investors; the latter also aims at improving the shareholder voice as part of 'good' corporate governance. In the EU/MS proxy voting is part of traditional corporate law protecting shareholders in the corporation; the EU's Shareholder Rights Directive facilitating shareholder cross-border voting in the EU fits the CLAP (Commission 2003) corporate governance concept of strengthening the position of shareholders in the corporation, also partly influenced by the LLSV study (par. 2.2). It is again remarkable that the EU, thus far, did not follow the US approach (of §14 SEA'34) to regulate proxy solicitation primarily as a securities law 'market transaction' and provide for adequate disclosure by the solicitor of such proxies. Again, the EU approaches the subject, at least in part, from the corporate law perspective of extending shareholders' rights, thus further intruding on the issuers' internal affairs. Also the examined MS approach this subject from a corporate law perspective: proxy voting, facilitated by the introduction of a record date, is allowed; securities law disclosure rules regulating proxy solicitation and voting to protect investors were not thus far introduced. Also the US-style mechanism/practice of management soliciting proxies, without extensive disclosure (only the default rule of art. 10(3) Shareholder Right Directive) is allowed in the UK, Germany (and at least is not excluded in the Netherlands). In the UK, the long-standing practice of the board to send out proxies is still prevailing. Provisions aiming to increase 'shareholder democracy' seem not to have eroded the tactical advantages of the directors in having two-way proxies going to them neither "for" nor "against" is filled in (LR 9.3.6 requires this to be expressly stated). Art. 10 (3) Shareholder Rights Directive, allowing restriction of the aforementioned practice by allowing the MS (amongst others) to restrict or exclude the exercise of shareholder rights through proxy holders without specific voting instructions for each resolution in respect of

699 E.g. rules related to the requirement to place information on the companies' website (AFS ch. 5.1a), See art. 5:25k (a) AFS.

which the proxy holder is to vote on behalf of the shareholder, is not implemented in the UK. In Germany, a management proxy can only be used with binding instructions.

3.7 Overall conclusions

Thus far, the results of the comparative analysis of shareholders' rights in the statutory charter of issuers seem to confirm my hypothesis that a) investor protection in the US is modelled primarily through high standards of initial and continuous disclosure, b) the protection does not come from extensive powers in the corporation's charter, c) that the division of powers indeed follows state rather than any federal corporate law (which is virtually nonexistent), d) that the corporation's charter is effectively controlled by the board, e) that the new EU securities law effectively results in a US-style investor protection by introducing a disclosure system under public oversight, f) that, however, investor protection also continues to build on shareholder protection in the statutory charter and, at least to some extent, also by corporate governance codes; in the Netherlands in particular this led to a strengthened position of the GMS and (groups of) shareholders opposed to the board (BoM/SB) of a Dutch listed public corporation g) that this seem to explain the emergence of codes on corporate governance, h) that this does not seem to be the case only for Member States but also for the EU level that continues to build on the *acquis communautaire* without clearly singling out the charter for issuers and to follow and support the mechanism of soft law on governance.

4

Board supremacy and discretion in the context of investor's actions: the Dutch right of inquiry as unique action for activist shareholders[700]

700 This chapter builds on joint research as reflected: M.J.G.C. Raaijmakers and P.A. van der Schee, Bescherming van beleggers in beurs-NV's: het enquêterecht als actie- en de business judgement rule als afweermiddel, in: H.J. Bruisten, M.J.G.C. Raaijmakers, A.F. Verdam, NGB-bundel 2010.

The HLG in 2002, in its report for modernising company law in the EU, advised providing shareholders in a general meeting or holding a maximum of at least 5 or 10% of the share capital with the right to apply to a court or appropriate administrative body to order a special investigation. A European framework rule should be adopted to this end (Recommendation III.8). The HLG places its proposal for an investigation procedure in the context of strengthening (minority) shareholders' rights and their monitoring role as 'principal' by stating: "In companies with one or more controlling shareholders, minority shareholders usually have no real influence, even if they vote. In group of companies and particularly in multinational groups, the minority shareholders of the subsidiary, and even those of the parent, may just not know where the real problems are. In such cases, what is needed for shareholders is to first find out the facts (e.g. about related party transactions) and then to consider the appropriate course of action, which could be a shareholder's resolution or even an action to hold directors liable." The HLG seemingly did not take into account the already evolving EU securities disclosure system under which issuers are required to provide investors on an annual and interim basis with information and which does not make a distinction between listed public and closed companies by stating: "the Group believes that the shareholders' right to vote and their standard right to information should be supplemented by a European framework rule on the right of shareholders to require a special investigation and the procedure for it. The Group recommends the extension of the special investigation right to all companies, whether listed, open or closed." The HLG's proposal also seems to be inspired by The Dutch right of inquiry (NCC Book 2 Title 8, arts. 2:344 - 359 NCC) and states: "The order should only be given when there is a serious suspicion of improper behavior, in order to avoid the procedure being used as a 'fishing expedition' or as an instrument of harassment. The investigation should be conducted by the court or administrative body ordering the special investigation, or by professionals under its supervision."

In this chapter it will be demonstrated that is not advisable to follow the HLG's proposal of 2002 to introduce an investigation procedure at EU level. This investigation by its nature is at odds with the securities disclosure system and as well with corporate law for (listed) public corporations. The analysis of chapter 4 also leads to the conclusion that the Dutch right of inquiry should be re-examined. This does not mean that the idea of a BJR, without a right of inquiry, is not of interest for preserving board supremacy and discretion. Also, the US and German systems offer a certain solution. Delaware goes even further and displays a totally different fundamental position by safeguarding the supremacy and discretion of the board also by statutory D&O/indemnification.

As analysed in chapter 2, investor protection in the US as well as in the EU is primarily based on securities law disclosure, public oversight and enforcement both in the primary market (IPO) by prospectus liability and in the secondary market by securities fraud. The second layer of investor protection is found in the US, UK and German derivative suits, albeit under the protection of the BJR and hence focussing on its limits, i.e. breach of fiduciary duties.[701] US (Delaware) and German law firmly establish the principles of board supremacy and dis-

701 a) Protection of shareholders, as especially provided for by EU continental systems, is also found in the possibility to annul decisions of the bodies corporate within the issuer's organisation. It can be considered as the bolt on GMS decision-making and in that sense as protection against abuse by the majority. Also decision of other organs as the board can be rescinded, e.g. art. 2:15 NCC. However

cretion. These are upheld in court when business decisions of the board are challenged in claims for damages and rescinding business decisions. The BJR protects the board by procedural requirements but also, more importantly, by the basic assumption of supremacy and discretion of the board. This may be set aside if the claimant – in a derivative suit – can prove a breach of fiduciary duties of the board vis-à-vis the corporation.

A comparative analysis of this issue reveals a remarkable difference in Dutch law, both regarding the basic rule on directors' liability, but more fundamentally with respect to the impact on the board's discretion of the case law under its investigation procedure. Board members may be held liable through an art. 2:9 NCC procedure, but not derivatively. As stated above, no BJR-rule will protect the board (members), although the standard used in *that* particular (but for issuers extremely unusual) procedure would presumably not differ substantially from that of the US, Germany and the UK since the judicial standard is rather high. The judicial assessment, however, does not start – as the BJR does – with a 'free zone' starting from its basic assumption of discretionary business judgement. Thus it lacks the certainty of the BJR-approach.

The more remarkable difference, however, is created by the Dutch investigation procedure, which is unique and does not exist in the US, at EU level or in the UK or Germany. The procedure is enacted in NCC Book 2, chapter 8 (arts. 2:344-2:359). The competent court is the Enterprise Chamber of the Amsterdam Court of Appeal.[702] It provide shareholders[703] with two successive rights in respect of a corporation (including issuers as well as private limited companies). First, shareholders (owning 10% of the shares or shares representing an nominal value of EUR 225,000) are entitled to petition for an investigation to be ordered if there are well-founded reasons to doubt proper ('juist') administration ('beleid') of the corporation, and – if the court so finds – appoint one or more investigators to investigate the administration and course of affairs of the corporation (during a certain period). Secondly, based upon the report of the investigator(s) they may request the court to establish that this constitutes mismanagement ('wanbeleid'), and order specific injunctions, including dismissal and appointment of new directors.[704] Apart therefrom the court may grant injunctive

in the Netherlands it is very rarely used as such in the case of issuers since the same or similar results can be reached by an investigation procedure.

702 Cornelis de Groot, *Corporate Governance as a Limited Legal Concept*, Netherlands: Kluwer Law International 2009, p. 34, technically, the Chamber of Business is a division of the Court of Appeals in Amsterdam (one of the five Court of Appeal in the Netherlands). Although part of the Court of Appeal in Amsterdam, the Chamber of Business acts as the court of first instance under the provisions on the right of inquiry. The aforementioned book gives an extensive overview of this investigation procedure in the Netherlands. For some other English articles on this investigation procedure see: M. Josephus Jitta et.al., *The Companies and Business Court from a Comparative Law Perspective,* Deventer: Kluwer 2004; J.B. Jacobs, 'The Role pf Specialed Courts Resolving Corporate Governance Disputes in the United states and in the EU: An American Judge's Perspective', *Ondernemingsrecht* 2007, p. 80-85; M.J. Kroeze, 'The Companies and Business Court as a Specialized Court', *Ondernemingsrecht* 2007, p. 86-91; L. Timmerman, 'Company Law and the Dutch Supreme Court', *Ondernemingsrecht* 2007, p. 91-95. See also the article of Erik P.M. Vermeulen & Dirk A. Zetzsche, 'The Use and Abuse of Investor Suits', *TILEC Discussion Paper, DP 2010-001*, January 2010, for interesting comparative research into the German rescission suit and the Dutch investigation procedure.

703 And holders of depository rights.

704 Cornelis de Groot, *Corporate Governance as a Limited Legal Concept*, Netherlands: Kluwer Law International 2009, p. 34, see this book for an extensive overview of this procedure.

relief (art. 2:349a NCC) during the whole procedure if the court finds that the state of affairs so require. Over the last decade, as will be set out below, this procedure and the possibility for (immediate) injunctive relief has turned the investigation procedure into a strong weapon for investors and activist shareholders to challenge the board's supremacy and discretion and thus 'provoke' a judicial review of its strategy, policies and actions. As will be set out below, this procedure effectively evolved towards a quasi derivative suit, at least to the extent that preliminary judgement may be acquired as to 'misconduct' of the board which can be used in a subsequent liability suit. In any event, this evidently provides claimants 'leverage' in subsequent settlement negotiations. In a comparative perspective, the most remarkable element of the investigation procedure is that it allows almost unlimited judicial review board action, in sharp contrast to the BJR-approach.
Meanwhile this procedure almost completely absolved the 'classical' action to annul (former) decisions/resolutions of the GMS and Dutch (Supervisory) board.
My next hypothesis is that board supremacy and discretion of the board of Dutch issuers has eroded remarkably over the last decade (being re-established only very recently by the Supreme Court), due to the fact that this investigation procedure has not been the subject of a fundamental review in the total change of the regulatory landscape for issuers and remained a corporate law procedure not taking into account the fundamental change in securities law.[705] This investigation procedure and its declared, but seemingly outdated, purposes will be tested and contrasted to the separate 'layers' of investor's protection offered by the completely revised EU and Dutch securities regulation, again in comparison with the US, EU, UK and Germany. Again I suggest the reader compare the tables as provided in the Annexes.

4.1 The rise of shareholder activism and the Dutch Investigation procedure as battle device

Professional investors (in shares) operate in worldwide markets and base their investment decisions not only on economic and other market factors, but also on rights protecting their interests as investors.[706] Against that stands a company's freedom of choice to choose the home base for its seat and the market(s) in which it wants to trade its shares and thereby choose the applicable securities law. As has already been explained in chapter 1, both viewpoints necessarily lead to an inquiry into the total regime for listed public corporations.
As has already been explained in previous chapters, pressure from investors on listed companies to raise profit (dividends), to raise the company's value on the stock exchange inter

705 Of course the Supreme Court in *ABNAMRO* and *AMSI* reconfirmed the supremacy and discretion of the Dutch board (BoM/SB), nonetheless the procedural structure of the investigation procedure almost automatically leads to substantial board review.

706 See Law and Finance research of Shleifer & Vhisny, researching (minority) shareholders' rights and made the conclusion that common in comparison to civil law countries offered better protection for shareholders and consequently explained the more liquid capital markets in the Anglo-American countries. However, they were heavily criticised for their research techniques (Cf. Zetzsche for overview critic).

alia through buying their own shares, splitting of core activities, distribution of the revenues (superdividends), giving up oligarchic regulations and protective devices increased. Listed public corporations often comply voluntarily. However, when activist investors, including hedge funds with explicit or silent support of other investors also without approval of the target, extort accelerated maximisation and realisation of shareholder's value by in essence debating the board's strategy, policy and other scenarios of the company, the supremacy and discretionary powers (business judgement) of the board (BoM and SB) comes under attack. The interest of the public corporation in having a clear governance structure has somehow got lost, at least in the Netherlands.

The unique Dutch investigation procedure has become a quick, successful and efficient extra coercive measure for internal and foreign investors, an action in their own interest for coercing the board (BoM/SB) of a Dutch public corporation to change its strategy and policy. Corporate litigation in the Netherlands has increased strongly. The Enterprise Chamber has shown itself to be responsive in allowing immediate injunctive relief even before having decided on the petitioners to order an investigation (i.e. whether there were well-founded reasons to do so on the proper administration of the corporation (art. 2:350 (1) NCC), exercising continuous supervision during the procedure, intervening in the business organisation of the firm and establishing new rules by interpreting prevailing Dutch corporate law not the least by a remarkably extensive interpretation of the general rule of 2:8 NCC (reasonableness and fairness, see par. 3.4.4). It thus allowed investors to 'enforce' their actions for change of corporate strategy and actions, but at the same time caused its rulings to become hard to predict. It ruled inter alia for an obligation to have (continue) a dialogue and for the SB to mediate with (specific) investors (*Stork* and *ASMI*), application of the DCGC on a subsidiary acquired in a successful bid (*Versatel*), to present a refusal of a third party bid on a subsidiary for submission/approval to the GMS (*HBG, ABN-AMRO*, see art. 2:107a NCC, as analysed under par. 3.3.9), to block voting on protective preference shares (*Gucci, RNA, Stork, ASMI*) to block a post-bid consolidation and integration of a subsidiary by means of a legal merger to freeze out minority shareholders (*Versatel*, *Shell*), to block a vote of the GMS to amend the articles for introducing a loyalty dividend (DSM), ex-post judgement of companies' policy and nullification of discharge already granted by a well-informed GMS (*ASMI*, *PCM*, see par. 3.4.4 on Dutch rescission suit art. 2:15), to allow investigation by the receiver in bankruptcy or on request of labour organisations (*PCM*; 25/5/2010) and to effectively allow fishing for facts in advance of a liability suit (*Van der Moolen*; OK 5.7.2010) or to settle disputes of a 'general contractual' nature (*Unilever*). Rulings of the Enterprise Chamber did not reveal any consideration or reflection of the new securities regulation, including disclosure and rules regarding takeover bids, as implemented in the Netherlands under supervision of the AFM as the competent government agency. Neither did its rulings reveal judicial reluctance as evidenced by the BJR. A lot of debate ensued.

Some of its rulings were overruled by the Netherlands Supreme Court. The Supreme Court reconfirmed the supremacy of the board (BoM/SB) and its discretionary powers (*HBG, ABNAMRO* and *ASMI*), limited immediate injunctive relief before a decision to order an investigation (art. 2: 350 (1) NCC), and, by requiring a strengthened judicial assessment of all interests involved (*DSM*), precluded any final judgement without an investigation report having been ordered and being available and limited reflex (overspill) towards a proper liability suit (art. 2:9 NCC) in *Skipper* and *Laurus*. The last-mentioned does not completely exclude 'fishing expeditions' (even in bankruptcy: *KPNQwest*), nor a judgement against a director or the rescission of a resolution for discharge.[707]

The effect of these Supreme Court decisions on the judicial policies of the Enterprise Chamber were seemingly limited. A more fundamental analysis and review therefore still seems to be vital. Guidance can be derived from the landmark decision of the Supreme Court of 9-07-2010 (*ASMI*).

4.1.1 Regulatory reform through securities regulation

The necessity for study already appeared from the reaction of the legislator and other regulatory organisations. Many of the aforementioned cases, not least *HBG, Stork* and *ABNAMRO* received a lot of attention in the media, professional literature and politics. They led to corrections of and supplements to the rules concerning Dutch (listed, not always singled out) public corporations. The Frijns Commission changed the DCGC, including by introducing a response time in case of threat of the supremacy of the board (DCGC, no. IV.4.4, response time)[708]. On its advice some proposals of Bill to raise the threshold concerning shareholder's right to put an item on the agenda from 1% to 3%, to clarify the identity of shareholders and reporting agreement on strategy, director's remuneration and 'claw-back'-rules were filed. The government, inspired by the *ABNAMRO*-case, initiated a debate on a market master for takeovers as e.g. the UK Takeover Panel. However this did not lead to the introduction of such a device nor did it change the division of roles between the AFM and the Chamber of Business. The Decree on Public Offerings (Besluit Openbare Biedingen) will, according to a recently published preliminary draft for consultation, be changed importantly and supplemented by 'a put up or shut up' rule-rule as inspired by the UK. This rule suits the bidding processes as regulated by securities law.[709] These aforementioned proposed reforms concern merely securities regulation; in the Netherlands the Minister of Finance is the first responsible. Other Bills, such as the introduction of the option to have a one tier board, in which also liability rules and rules concerning a conflict of interests will be changed, are the responsibility of the Minister of Justice. In these proposals issuers are not singled out. The investigation procedure also is the competence of the Minister of Justice, as part of Book 2 (Netherlands Civil Code) on Legal Persons.

707 See Enterprise Chamber 5-07-2010 (KPN/Qwest); Chamber of Business 5-06-2010 (Van der Moolen); Chamber of Business 27-05-2010 (PCM), *JOR* 2010/189 and ASMI, Chamber of Business 5-08-2009, AA 2009, 734, with reference M.J.G.C. Raaijmakers.

708 A shareholder shall exercise the right to put an item on the agenda only after he consulted the management board about this. If one or more shareholders intend to request that an item be put on the agenda that may result in a change in the company's strategy, for example through the dismissal of one or more management or supervisory board members, the management board shall be given the opportunity to stipulate a reasonable period in which to respond (the response time).

709 M.J.G.C\. Raaijmakers & Van der Schee, 'Regulering en handhaving van overnamebiedingen in perspectief', in: Marco Nieuwe Weme, Gerard van Solinge, R.P. ten Have (eds.), *Handboek Openbaar Bod*, Kluwer Juridisch, 2008.

4.1.2 Preliminary draft Right of Inquiry: not focused on listed public corporations

The Social Economic Council (SER), on request of the government, published its advice 'Balanced Entrepreneurship', which focused on Dutch issuers.[710] Some roundtable conferences and empirical research by Maarten Kroeze and others were the basis for a draft Bill, published for consultation, to amend the investigation procedure. This draft Bill received wide attention in the literature.[711]

Quite remarkably, the explanatory memorandum to the draft Bill observes: 'the contemporary system does not enfold fundamental problems, however the right of inquiry can be partly be ameliorated'. That observation is, as far issuers are concerned, not underpinned by a fundamental analysis of the applicable renewed securities regulation (FSA-regime), nor the affect of the right of inquiry as developped as a means for 'tactical litigation'.[712] Also the reactions in the literature do not pay a lot attention to the its very different function for issuers compared to (small) private limited corporations and other legal entities.[713] Meanwhile the draft addresses some worries of issuers by a) raising the financial thresholds for making a request (art. 2: 346b NCC), b) the possibility for the issuer to request an inquiry, c) the codification in art. 2:349a NCC of the rules set by the Supreme Court ('DSM-rule'): weighing of interests in case of immediate measures and the court's obligation to decide on the petition 'in reasonable time', still allowing immediate injunctive relief before that judgement.

The use of an investigation procedure as a 'quasi-liability suit' will not be limited, nor will a BJR be introduced. Nonetheless, the Enterprise Chamber can limit the liability of investigators and directors (BoM/SB) appointed by the Enterprise Chamber itself (arts. 2:350 (3) NCC and 2: 357 (4)). This may simplify actions against issuers. Art. 2:351 (4) NCC would rule for hearing board members (BoM/SB) who may feel threatened by subsequent liability suits: 'those are named in the inquiry report' should have the opportunity to make remarks in case of fundamental results relating to themselves'. Otherwise the draft Bill does not change the procedure. Hence, existing doubts and questions will not be resolved.

710 SER-Advies Evenwichtig Ondernemingsbestuur, nr. 08/01 (SER); consult the rapport on which it is based nr. 08/01a, Evenwichtig Ondernemingsbestuur: Externe consultatie en (onderzoeks)rapportages, M.J.G.C. Raaijmakers, Cristophe van der Elst, Abe de Jong, Frans Overkleeft and P.A. van der Schee contributed to these reports.

711 Amongst others: S.M. Bartman and M. Holtzer, 'Enqueterecht voorzichtig onder het mes', *Ondernemingsrecht* 2010, p. 76; J. Flemming, 'Het voorontwerp aanpassing enquêterecht, in: Holtzer et al., *Geschriftten vanwege de Vereniging Corporate Litigation 2009-2010,* Deventer: Kluwer 2010, p. 111-134; M.J. Kroeze and B. Assink, 'Rechterlijke toetsing van ondernemingsbeleid, Hoe marginaal zou 'marginaal' moeten zijn', in: K.M. van Hassel and M.P. Nieuwe Weme (eds.), *Willem's wegen*, Deventer: Kluwer 2010, p. 11-32; see also their joint column, 'Ja, wij willen', *Ondernemingsrecht* 2010, in which they plead for introducing a BJR in the Netherlands; compare also B.F. Assink, *Rechterlijke toetsing van bestuurlijk gedrag,* Deventer: Kluwer 2007, M.J. Kroeze, *Bange bestuurders*, Deventer: Kluwer 2005, B.F. Assink and D.A.M.H.W. Strik, *Ondernemingsbestuur en risicobeheersing op de drempel van een nieuw decennium: een ondernemingsrechtelijke analyse,* Preadviezen Vereniging Handelsrecht 2009, Kluwer 2009; B.F. Assink, *De januskop van het ondernemingsrecht,* Deventer: Kluwer 2010 cf. for what I consider a 'securities fraud'-action: B.J. de Jong, *Schade door misleiding op de effectenmarkt,* Deventer: Kluwer 2010.

712 Cf. M.J.G.C. Raaijmakers, *Naar een Wetboek Ondernemingsrecht?,* Den Haag: Boom Juridische Uitgevers 2009, p. 53.

713 E.g. dispute resolution for closed companies can be revised in the law related to these closed corporation, as have been done in other jurisdictions: e.g. see regulation concerning the GmbH, LLC and SAS.

The draft Bill rejects the suggestion of the Social Economic Council to apply the BJR on the 'entrance' to the procedure (ordering of an investigation). The draft Bill does not provide a proper analysis of the relation between the 'institutional' purposes, stemming from another period in time, and the procedural form and position in Book 2 of the right of inquiry and the renewed public- and private law protection of investors in the new securities law: 'full disclosure', public supervision by the AFM and its power to request restatements of disclosure documents, new liability actions ('securities fraud') in case of misleading information in accordance with art. 6:193a NCC (and art. 3:305a NCC and art. 7:907 ff. NCC) and a 'post-investigation' liability suit under art. 2:9 NCC.
The draft Bill does not assess the *ratio legis* for issuers in comparison to the new securities regulation or other jurisdictions, nor assess the impact on regulatory competition for issuers. The analysis pursued in this study aims at contributing to such assessment and clarifies the strong need for a proper distinction between aims, means and enforcement of the different areas of securities and corporate law. A further analysis of the aims and means of the Dutch investigation procedure may further reveal the importance of this.

4.1.3 The right of inquiry as 'action' in protecting a listed public corporation's investors and the meaning of its open purposes

The implementation of the European Prospectus-, Transparency-, Takeover- and Market Abuse Directive argues for contemplation on private law devices as a whole in enforcing the 'new' securities regulation; the right of inquiry in its unique set-up as being only available for a Dutch listed public corporation in protecting the interest of investors has not been involved in that contemplation.[714] For the Netherlands, the investigation procedure still offers additional means for enforcement to investors. It allows the Enterprise Chamber much freedom for judicial lawmaking, certainly if compared to other jurisdictions (as will be set out below). Its general character does not direct its embedment in the total regime of corporate and securities law for Dutch issuers.
In making up for the lack of analysis we should reconsider the original, by now 40-year-old general set up and purposes of the investigation procedure: 1) bringing matters in the open, 2) restructuring and restoration of sound relations by means of measures that serve to reorganise the enterprise of the legal person concerned, 3) establishing 'responsibility' (note: not liability) for mismanagement that may exist, and 4) prevention.[715] The question

714 The plea (November 2002) of the HLG (with Jaap Winter as its chair) for developing a European action so far has been without results; Corporate Governance Action Plan (21-05-2003); Klaus Hopt, 'Modern Company and Capital Market Problems: Improving European Corporate Governance after Enron', in: John Armour and Joseph McCahery (eds.), *After Enron, Improving Corporate Law and Modernising Securities Regulation in Europe and the US*, Oxford: Hart Publications 2006, *p. 466.* In my view Hopt's position that the 'investigation'-procedures in France, Germany and Denmark as discussed are similar to the Dutch right of inquiry is inaccurate. Where he discusses the protection of the German BJR, he overbooks the fact that the BJR in the Netherlands is not provided for; in his argumentation related to information asymmetry he ignores the strengthened disclosure obligations under European securities regulation.

715 Supreme Court (Dutch Supreme Court, further: SC) 10-1-1990, *NJ* 1990, 465/466 (OGEM); *AA* 1990, 858 with reference Raaijmakers; SC 26-06-2009, 107 (KPN/Qwest I); Asser/Maijer/Van Solinge & Nieuwe Weme 2-II, *Rechtspersonenrecht:De Naamloze en Besloten Vennootschap,* Deventer: Kluwer 2009, no.729 distinguish between curative, inquisitorial and inquiries with antagonist characters.

arises: do these purposes still fit in the now fundamentally changed corporate and securities law regime for listed public corporations?
Notably, the Supreme Court (KPNQwest)[716] also apparently addressed that question. Conflicts on property rights and their factual background are not covered by the scope of the investigation procedure, which raises the question of whether the type of conflicts between investors and issuers are of that nature.[717] More importantly, the Supreme Court held that the power of the Enterprise Chamber to order an inquiry remains in itself a discretionary matter, but should be used by properly weighing all the interests involved and that the ruling should be underpinned by facts and circumstances in a specific case: 'In weighing these interests (*the Enterprise Chamber, PvdS),* as much as it will take place in a concrete case, besides the purpose of the right of inquiry also the drawbacks against a broad application of the right of inquiry have to be taken into account, and also the nature of the conflict as exists between the applicant and the legal person has to be taken into account. (…). A certain motivation may (…) be required in case of facts and circumstances who (clearly) plea for or against granting the request for an investigation, and the Chamber of Business nevertheless comes to a other judgement.' This evidently seems to be an incentive for a more reserved Chamber of Business policy.

4.1.4 The historical aims of the investigation procedure do not reflect changes of the regulatory and societal framework causing unpredictability of its application in practice

The aims of the investigation procedure as they were formulated upon its introduction in 1970/1971 and repeatedly confirmed in case law, were not re-assessed over time nor upon the introduction of the new securities regulation, the emergence of shareholder activism or the introduction (and revision) of the DCGC. That is quite remarkable since closer analysis shows that these aims can be explained historically by an analysis of the 'institutional' view on 'large' corporations and issuers (see next paragraph) and the broad regulatory aims of enterprises, but seem hardly adapted to function in the present regulatory environment. To illustrate this point I will now first briefly discuss the ('historical') aims of the investigation procedure.
a. '*Bringing matters in the open*' seems outdated in view of the vast extension of strict annual and intermediate disclosure and transparency rules in the AFS (Wft), public oversight by the AFM, the AFM's power to request restatement of annual reports, the supervision of the AFM on interim reports and price-sensitive information, and on the enforcement of rules of conduct in case of a public bidding. Simultaneously, discovery rules have also been amended. See: art. 6:193a ff NCC, art. 162, 284 (1) and 843a Procedural Rules, enabling a plaintiff to require information ('discovery procedure'). Hence, it is hard to see what room is left for the court to establish that there are 'well-founded reasons to doubt good administration of the corporation' or to legitimise immediate injunctive relief?
b. 'restructuring and restoration of sound relations by means of measures that serves to reorganise the enterprise of the legal person concerned.' In small private firms this explains the

716 Supreme Court 17 december 2010, LJN BO 3356 (KPNQwest).
717 Cf. also the *Unilever* –case.

court's power to resolve a deadlock. Historically, it also refer to disputes with employees, such as on the consequences of a major impact for employees. However, applied to issuers with dispersed shareholders a 'blocking' deadlock in practice is hard to imagine. Given that an issuer is free to determine its own internal affairs, application of this aim remains problematic. Still, the Enterprise Chamber used its discretionary power to rule on 'desirable' governance setting aside the issuer's charter (such as in the *ASMI*-case). Again, it leaves open the question of when this aim constitutes the required reasonable doubt to grant the petition for an investigation and, moreover, for immediate injunctive relief. c. '*Establishing responsibility for mismanagement that may exist'.* An investigation procedure by its nature is not a liability suit, but, apart from often affecting the stock process, board members of issuers may suffer reputational loss, be forced to divert much management time and attention to 'damage control' during the procedure and, if the court finds mismanagement *of the issuer,* also result in factual and legal 'disqualification'.[718] [719] Again, looking to the initial admission to the procedure, statements of fact in terms of mismanagement *of the board* will blur the borders with private enforcement through the GMS powers as well as with the liability-procedure of art. 2:9 NCC. Thus, it evolves towards a quasi-liability procedure, however *without* the procedural safeguards of that procedure and different standard of 'serious reproachability' ('ernstig verwijtbaarheid'). Thus it allows 'fishing *expeditions'* ('pre-*trial discovery*'),[720] also for a receiver in bankruptcy[721]

d. '*Prevention*'. Effectively this aim comes close to 'naming and shaming' of board members. It has not been re-assessed upon the disclosure and transparency regime for issuers, nor to the confidentiality rules under the new securities regulation that have to be observed in public oversight by the AFM to protect (the reputation) of issuers and avoid influence on the stock price. Again, what does this aim mean for the initial judgement allowing entry to the investigation procedure?

Since these questions and observations seem to be clear illustrations of the central theme of this study, i.e. the distinct regulatory means, ends and effectiveness of securities and corporate law for issuers, I will elaborate in the next paragraphs in somewhat more detail the original objectives and present application of the Dutch investigation procedure to issuers.

4.1.5 Meaning of the 'institutional doctrine': interest of the firm

One of the basic elements in Dutch corporate law is its conceptual starting point to regard a corporation as an 'institution' separated from its shareholders with its own interest. It reflects the basic structure of corporate law that was merged (1976) into the Civil Code under the common denominator of 'legal persons' (comprising both large issuers and small

718 Such as 'improper or irresponsible corporate governance', 'worn-out governance', 'violation of elementary principles of responsible entrepreneurship'. If a given discharge is rescinded on these grounds, then the BJR again comes into play.

719 Cf. M.J. Kroeze, *Bange bestuurders*, Deventer: Kluwer 2005.

720 Cf. D. Slotema, ''Vissen' naar het feitensubstraat voor de civielrechtelijke aansprakelijkheid van bestuurders en commissarissen', *V&O* 2010, p. 105-108.

721 According the Enterprise Chamber 05-07-2010 (KPNQwest) *LJN* BN0254 the Netherlands association of securities owners (VEB) reached a settlement with the corporation; however the withdrawal has been refused with an appeal on the public interest.

private corporations with one or a few shareholders).[722] For longtime it supported board supremacy and discretion (also in private companies). The objectives of the investigation procedure as briefly described above fitted into that picture.

However, case law based on the investigation procedure took its own route amidst the emerging corporate governance debate and the creation of the new securities regulation by allowing activist shareholders to pursue their own interests in a way that appears to be unfamiliar to the other systems and contrary to the concept of the issuer as an 'institution' but still using the original 'institutional' objectives of the investigation procedure. More remarkable is that the draft Bill to amend the procedure does not address these changes. Its explanatory memorandum even seems to suggest that the Enterprise Chamber could take the driver's seat of the corporation and its board (BoM/SB): 'In case of a *business decision*, the board has *a certain discretionary freedom* (sic!), restricted by the law, articles of incorporation and decisions amongst others of the GMS. Also the court has to *take* this discretionary freedom *into account*. In case *of a business consideration of policy* Netherlands corporate law takes as starting point that the board (BoM/SB) has to act in the interest of the legal entity and its connected enterprise [as explained under this also applies to the other systems]. The board (BoM/SB) is not allowed to focus entirely on the interests of the shareholders in the legal entity.' And further: 'So it is important whether *the board is entitled to discretionary freedom*. (...) That discretionary freedom is lacking when the board has to adhere to statutory requirements and requirements derived from the articles of incorporation, such as convening a GMS and bookkeeping- and annual accounts requirements.[723] This discretionary freedom always will exist, however according to the circumstances and requirements following from regulation can be tested [Italic PvdS].' The explanatory memorandum does not, also for issuers, put first and foremost that discretionary freedom.

Apart from the vagueness of the 'institutional' concept and of the distinction between decisions related to the legal entity and 'business decisions', also by Assink and Kroeze, which seem to me to be inextricably related to each other,[724] the basic relation between 'interest' and 'action' seems to be blurred in the abstract debate on a broad or a narrow interpretation of the interest of the 'legal entity'. Particularly for issuers with continuously changing shareholders and many 'involved interests', the law should be clear in which directly interested parties should be recognised as having a course of action to sue the issuer for violating that interest. The confusion is illustrated by the fact that some have defended that

722 'In the Netherlands the board shall have to act in the interest of the firm, which entails more, then the interest of the shareholders.' In case of small (personal) private limited companies this will not always apply. Cf. M.J.G.C. Raaijmakers, *Joint Ventures,* 1976, p.85 and further; M.J.G.C. Raaijmakers, *Rechtspersoon tussen contract en instituut*, Oratie: UvT, Deventer: Kluwer 1987; M.J.G.C. Raaijmakers, *Enkele rechtsvergelijkende beschouwingen over joint ventures, preadvies NVvR* 1992; M. J. G. C. Raaijmakers, 'Besloten vennootschappen: 'quasi-nv' of quasi-vof'? Enkele rechtsvergelijkende notities', *Ars Aequi* 1994, p. 340-348; M.J.G.C. Raaijmakers, *Naar een Wetboek Ondernemingsrecht?,* Den Haag: Boom Juridische Uitgevers 2009.

723 'The court can examine whether eventual breach of such requirements is sufficiently severe for the conclusion that there are well-founded reasons to doubt good policy on the part of the corporation or mismanagement.'

724 If the core from that is that the board (BoM/SB), as long as it is in function and not fired, independently determine the policy and strategy of the corporation as 'agents', then the law has to acknowledge that and the board could only be sued for 'improper' governance through art. 2:9 NCC procedure.

pressure groups and the Attorney General acting 'in the public interest' should be admitted standing in the investigation procedure in case of violation of basic principles of 'social responsible entrepreneurship.'[725] Even if one were to take a neutral stand it seems inconceivable that the legislator itself should explicitly propose and debate such extension of the traditional scope of corporate actions. Has the Enterprise Chamber the power to refuse a request for withdrawal of a petition for an investigation on the ground that pursuance of the procedure is no longer directed by the petitioner but should be assessed against such public and social interests?[726] Such an implication of that 'institutional doctrine' seems to require clear proposals and proper debate. Again, what does it mean for the admission of petitioners to the investigation procedure? What would, looking from the issuer's perspective, the impact of such 'contingent risks' in an offering circular or annual disclosure documents be? Disclosure should be clear and understandable and investors cannot be required to minutely study the peculiarities and unpredictable risks of any application of the investigation procedure that remains unique in the international capital market. Evidently all this may impact upon regulatory arbitrage.
As mentioned earlier I will now turn to a more detailed analysis of the original objectives of the investigation procedure.

4.2 'Bringing matters into the open' and investor protection through securities – and/or corporate law: EU and US

If we take again the purpose of 'bringing matters into the open' as one of the grounds for judicial assessment of a petition for an investigation, then the meaning for issuers should relate to the context of the (re)newed European Securities Law as implemented in the Netherlands ASF. As extensively discussed already in chapter 2, the capital market (shares) and investors in these markets are primarily protected by strict and extended securities law under public oversight, mainly: mandatory disclosure and transparency rules to enable investors to monitor their investment and to decide to buy, sell or keep their shares. All this follows the issuer's going public and by submit, regardless of which corporate law and the corporate charter is appicable, the issuer e.g. to Dutch securities law.
In the US, the mechanism of an IPO will follow and adhere to the applicable US federal securities laws (SA'33 and SEA'34). US corporate law, as analysed in chapter 3, only plays a minor role in protecting investors in a listed public corporation. However, the corporate derivative suit provides a device for investor protection. It is that action, in which the US *Business Judgement Rule* plays its role to protect board supremacy and discretion.

725 Cf the joint introduction of De Jongh, Eijsbouts, Kristen and Timmerman accompanying the NJV-preadviezen; A.J.A.J. Eijsbouts, F.G.H. Kristen, J.M. de Jongh, A.J.P. Schild en L. Timmerman, *Maatschappelijk verantwoord ondernemen, Preadviezen NJV* 2010, Den Haag: Kluwer 2010 and A.J.A.J. Eijsbouts, 'Elementary principles of social responsible entrepreneurship, cf. also Raaijmakers, *NJB* 2010, p. 1410-1413.

726 Cf. Enterprise Chamber, 5-07-2010 (*LJN* BN0254): request VEB for withdrawal inquiry has been declined with an appeal on social interests.

As already discussed in chapter 2, the 'federal' European securities law only came into existence in the last decade: Prospectus Directive and Regulation, Transparency Directive, Market Abuse Directive, Admission Directive, IAS Regulation and Takeover Directive. Also here disclosure is the central focus of securities regulation: initial and continuous disclosure duties for issuers. This also underpins the 'market for corporate control' and the monitoring and governance functions of the market.
Because in the EU the dichotomy between securities and corporate law was hardly perceived, let alone regulated, the protection of investors in shares was previously primarily regulated by corporate law. Additional 'self-regulatory' market rules were set by (mutual) stock exchanges. Evidently market structures and systems differed, such as dispersed versus block holding systems, different social and historical developments.[727] Statutory law and articles of incorporation provide shareholders 'as member' individual and collective rights: meeting, agenda, information and approval rights. These rights, as in the Netherlands (elaborated in chapter 3), are much more extensive than in the US.
On top of all that, the Dutch investigation procedure still uses the standard and objective of 'bringing matters into the open'. No guidance has been given by the legislator as to how this should be interpreted in view of the new set of rules in securities law disclosure and public oversight. For an extensive comparison of securities and corporate regulation protecting investors/shareholders I refer to the chapters 2 and 3 and the annexes. However in short, the by now 'federal' EU disclosure system provides a similar US 'full disclosure'-system. In my view 'bringing matters into the open' as a ground for the investigation right of inquiry for Dutch issuers has become obsolete. Note that this standard was formulated at the time when the rules on annual reporting were dealt with by just one article (!): Code of Commerce art. 43c (that was replaced – in 1970 – by the Act on the Annual Accounts). This applied to issuers as well!

4.2.1 Action against the public corporation because of misleading disclosure ('restatement' and 'securities fraud')

Thus, if and insofar the original objectives might be interpreted as a means to enforce the high level of securities law obligations on disclosure of annual and intermediate information, that objective has by now been superseded and effectively replaced by the new mechanisms. To that extent the investigation procedure has become obsolete (cf. also German background shareholders' broad information rights which led to abusive suits, see chapter 3, par. 3). As discussed above, Dutch investors and the AFM can start a restatement action in case of incorrect or misleading annual reports (art. 2:447 NCC and further), although – with respect to Dutch issuers – in principle only *after* adoption of the annual accounts by the GMS.[728] Dutch law is silent on any possible procedural overlap of such actions with the investigation procedure. So far, however, these actions do not exclude each other. Consequently and remarkably, issuers may thus be exposed to them simultaneously; in practice, therefore, also as a device to press issuers to settle such court actions.

727 See e.g. Mark J. Roe, *Political Determinants of Corporate Governance*, New York: Oxford University Press 2003.
728 Mark J. Roe, *Political Determinants of Corporate Governance*, New York: Oxford University Press 2003.

The basic action for private law enforcement against a breach of disclosure duties is offered by the 'securities-fraud'-action (cf the comparative analysis of chapter 2). This action can be brought by investors against an issuer on the ground of misleading information (in issuing prospectus, annual accounts/report or other interim information): in the Netherlands art. 6:193a NCC. Unlike the US, the EU-Directives and Regulations do not provide for a *federal* 'securities fraud'-action (and strict liability rules, as provided by §§ 11 and 12 SA'33). SOx, as already mentioned, strengthened demands of quality and trustworthiness and made the sanctions for breaches thereof more severe. In the EU, the MS shall provide, according to the various securities law directives and regulations, adequate means for private enforcement.[729] The result is not uniform. But clearly the investigation procedure was not intended or considered to operate as a course of action to fulfil these European requirements, neither did it replace the actions for misleading information as enacted in art. 6:193 a NCC (misleading commercial practises) and art. 6:162 NCC (general tort action), also not for '*bringing matters into the open*'. The Netherlands does not provide for a class action, although the possibilities have been extended by art. 3:305a NCC (collective action) and – if a settlement has been reached – also by the possibility to have such settlement declared binding by court decree for a 'class': art. 7:907 ff. NCC, allowing such universal binding settlements for a whole class of claimants at the petition of parties to the settlement agreement.[730] Remarkably, the recent decision in *KNP/Qwest* (5.7.2010) forestalls the reaching of a settlement just by declining the agreed withdrawal of the brought inquiry by the Dutch Association of Security Owners (VEB).[731]
With the Dutch 'securities-fraud'-action (art. 6:193a NCC), the Netherlands meets the Prospectus and Transparency Directives. That action for compensating damages is aimed at the issuer itself on the ground that the issuer has misled investors and thereby caused the damage. Not the board's conduct/actions, but misleading by the corporation is the foundation of this action. Hence, the BJR does not play an independent role in this action.
In the German Verkaufprospektgezets (1990) and the Wertpapierprospektgezets (2005), Germany introduced new rules. § 37b WpHG provides a general action for securities fraud and the KapitalanlegerMusterverfahrensgesetz provides a collective action. For the UK, the Financial Services Markets Act (§ 90 FSMA) and the previous regulation in the UK CA 1985 is referred to.
All these regulations provide investors with an action to claim their damages in the issuer itself in that they (whether or not as a class) suffered on grounds of misleading information by breach of securities disclosure requirements, whether by (initial or subsequent) issue of securities (shares) by a misleading prospectus, or continuous and interim information

729 See e.g. art. 6 Prospectus Directive: "to ensure that their laws, regulations and administrative provisions on liability apply to issuers, the bodies referred to in this article or the persons responsible within the issuers".
730 See the Court of Appeal 29-07-2009 (Shell-settlement), *JOR* 2009/197 (with reference A.F.J.A. Leijten, about which B.J. de Jonge, p. 336 and further); cf. I.N. Tzankova, 'Kwaliteitsbewaking van belangenbehartiging bij collective acties en massaschade', in: Holtzer et al., *Geschriften vanwege de Vereniging Corporate Litigation 2009-2010,* Deventer: Kluwer 2010, p. 135-161.
731 Dutch Supreme Court, 17 December 2010, LJ BO3356 (KPN/QWest), rescinding the order of the Enterprise Chamber to continue the research.

requirements (annual reports, quarterly and interim announcements). It is difficult to argue for any role of the investigation procedure in this whole context.

4.3 Establishing responsibility for mismanagement on the part of the corporation and (derivative) actions of the corporation towards its board members

At the next level of private law protection of investors we see the action of the corporation (issuer) itself, as represented by its board, against its (previous) directors (BoM/SB) in collecting compensation for damages (and thereby – indirectly – against its investors). Kroeze has proposed introducing a derivative suit in the Netherlands with adequate thresholds (demand or Vorferfahren).[732] However, Bill 31 763 (one-tier board model) does not take that route. This will be explained below.

The Dutch ground for this general action in NCC Book 2 on 'legal persons' is 'improper management/supervision' (art. 2:9 NCC). It is not directed at directors of *entrepreneurial* legal entities, let alone issuers. Dutch law does not recognise a BJR as adopted in the US and Germany, and thoroughly analysed by Assink, in which the business judgement of the board (BoM/SB) in a liability suit will be honoured by the court as principle starting point. The BJR will only be disregarded in case of (serious) breach of duties of loyalty and – lesso – of duties of care. The Supreme Court in the *Staleman*-case[733] held that a claim will be granted only if the alleged misconduct of directors meets the standard of 'serious reproachability' ('ernstige verwijtbaarheid')'. This does not involve a BJR since its crucial 'hands-off' starting point is lacking. Again, these parameters and their impact on issuers have not been re-assessed in relation to the investigation procedure.

As stated before, the key issue remains whether the board of an issuer is allowed to discharge its function and operate independently and on its own discretion can determine, settle and execute the issuer's strategy and policy in its own interest , while being assured that if it is sued (for damages) its own 'business judgement' will be upheld in court and not be replaced by any 'wisdom of hindsight'. Hence, the focus will shift to assessing any alleged breach of loyalty, fraud and possible self-enrichment. However, the starting point remains that the board (BoM/SB) performs the issuer's function and character as 'entrepreneur'. Thus it should aim for its success, even though Dutch law, other than UK CA 2006, does not explicitly assign such. Success will be achieved in the market in which products and services will be developed and sold in competition with others. Businesslike production, freedom of entrepreneurship and open competition shape the accepted foundations of our (European) market economy. This implies at micro level that success for entrepreneurs will never be assured and the associated risk of failing will always be present. Innovation of products, services and markets is key to success. It takes innovative guts, courage and perseverance to overcome scepticism and to find and persuade financiers. That brings us to the

732 M.J. Kroeze, *Afgeleide schade en afgeleide actie,* Den Haag: Kluwer 2004, p. 342.
733 Supreme Court 10-01-1997, *NJ* 1997, 360.

key questions of societal and legal objectives of the legal regime for issuers. American and German law clearly place their BJR just from that general perspective of board supremacy and discretion upfront to give room for in its nature risky undertaking. How does the more limited, but nonetheless broadly formulated purposes of the right of inquiry fit in with that, here: establishing responsibility for alleged mismanagement on the part of the corporation.

4.3.1 The investigation procedure as quasi-liability action?

Although establishing who is responsible for 'mismanagement', still serves as the objective for an investigation, also for issuers, the procedure is not equipped for that purpose. Nonetheless, a request for an investigation – also in bankruptcy – is often used and even clearly focuses on (the preparation of) a liability suit[734] (or a settlement). It should be noted, however, that even the final judgement of 'mismanagement of the corporation' (art. 2:355 NCC) following an investigation and report, still – In itself – does not constitute a judgement on 'improper governance/management or supervision' of individual board members or commissioners as required in a liability procedure.[735] A fortiori this applies to the judgement as to whether there are well-founded reasons to doubt good policy. However, practice is different.

4.3.1.1 'Well-founded reasons to doubt good policy' with entrance to the Investigation procedure; not the same function as the 'demand' (US) or Vorferfahren (Germany) procedure

If an investigation does indeed aim at preparing a liability suit, the petitioner, remarkably, can suffice, without *demand* or *Vorferfahren* (see below), with a statement that there are well-founded reasons to doubt good policy. This in practice is a far lower threshold than required in a liability suit where the claimant has to state the facts for such an allegation and has the burden of proof for 'improper governance/management' in the sense of art. 2:9 NCC.[736] Thus, the petitioner passes (any assessment by) the board (BoM/SB) and the GMS and the inquiry's ('fact-finding') costs will be borne by the issuers. That investigation, moreover, has a broad, but time-limited, character. By its nature, it focuses on policy and strategy of the incumbent board (BoM/SB) *being in function*. That *alone* has a malign affect on the reputation of the issuer and its board (BoM/SB) and may substantially influence the stock price (and consequently a possible duty of the issuer to disclose such price-sensitive information). A court in a subsequent art. 2:9 NCC-liability procedure will not be strictly bound to a final judgement in an investigation procedure, but that does not take away from

734 As recently declared, the purpose of the inquiry against Van der Moolen; see FD; cf also *Laurus* and *Skipper Club Jaarsma* and *KPN/Qwest*.

735 Art. 2:354 NCC: though the costs can be claimed from the board, in case of 'improper policy'.

736 B. Assink 2007, p. 477: the authority of the Chamber of Business to grant an inquiry is discretionary. Thereby besides the purposes of the investigation procedure the Chamber of Business has to also take into account the drawbacks of the corporation and the nature of the conflict between the applicant and the corporation. See also DSM. It is not clear for entrance to the procedure whether a presumption of mismanagement has to be present and/or the applicant has to state that one of the purposes of the investigation procedure can be realised. See Assink, p. 400 on the threshold for granting an inquiry: 1) absence 'good policy' not exchangeable with presence of 'mismanagement'. Absence 'good policy' entails possibility 'unjust policy'. 2) Presumption of 'unjust policy' or 'mismanagement'. Policy at least qualified as 'unjust'; presumption mismanagement is possible, but not required.

its 'biasing impact'. This is certainly the case for established facts when directors (board members and commissioners) have appeared in the procedure.[737] Some more notes on this will follow.

4.3.1.2 Prejudicial working of an investigation procedure

In cases against issuers, the investigation will often not result in a final judgement on 'mismanagement on the part of the corporation'. Nonetheless, decisions on the initial request, interim decisions and decisions on granting injunctive relief (arts. 2:350 and 2:349a NCC) often imply (disqualifying) judgements by the Enterprise Chamber on policy, strategy and operation of the board (BoM/SB), that may be prejudicial in a subsequent liability procedure and/or negotiations for a settlement.[738]

That prejudicial effect tends to erode the independence of the board and its discretion entailing only breach of duties of loyalty[739] or clear breach of 'duties of care' should be postulated, proved and judged. That point of departure prevents 'risk aversion' (because of developments of recent years leading to the 'credit crunch', it would be more suitable to use the term: 'excessive passivity'). But this should be the realm of a direct art. 2:9 NCC-liability action. If for that procedure – without a BJR – the marginal test of the norm 'serious reproachability' ('ernstig verwijt') prevents the court from taking the driver's seat from the entrepreneur, it is hard to reconcile the fact that the Enterprise Chamber in granting entrance to the investigation procedure, totally bypasses that starting point, adjourns the request for an inquiry, already takes immediate measures and their allows investors to circumvent, their duty to postulate facts and burden of proof in the ordinary court (2:9 NCC).[740]

4.4 Derivative suit in the US (Delaware), Germany and the UK: point of departure independence of the board (BoM/SB) and its discretion

Unlike the US, Germany and the UK, Dutch law does not explicitly provide for a derivative suit allowing shareholders to bypass the board's representative power to sue on behalf of the company. However, its investigation procedure as analysed above developed towards a quasi-derivative suit in preparation of further action(s) by the issuer or – in bankruptcy – the receiver (without major constraints on starting such a procedure). A comparative analysis reveals that jurisdictions providing for a derivative suit also provide for preparatory procedures (US demand procedure, German 'Vorferfahren') to be observed by the plaintiff before

737 The dilemma (cf. Enterprise Chamber *JOR* 2005/119) for board members and commissioners is still whether or not to appear in the investigation procedure; if they appear, then a possible judgement of the Enterprise Chamber will be binding in a later art. 2:9 NCC procedure, if they do not appear, influence on possible judgement of 'mismanagement on the part of the corporation' by the Enterprise Chamber is not possible. Cf. also Flemming.

738 Cf. M.J. Kroeze, *Bange bestuurder,* Deventer: Kluwer 2005; B.F. Assink, *De Januskop van het ondernemingsrecht,* Deventer: Kluwer 2010.

739 Cf. G.J.H. van der Sangen, 'Tegenstrijdigbelangperikelen, the saga continues', *TVoB* 2010, p. 44-50.

740 Cf. P.J. van der Korst and I. Wassenaar, 'Maak van de enqueteprocedure een dagvaardingsprorcedure', in: K.M. van Hassel and M.P. Nieuwe Weme (eds.), *Willem's wegen*, Deventer: Kluwer 2010.

being allowed such a suit. These procedures effectively serve to protect the corporation and its board from 'frivolous actions'.

In the US, a liability suit can be brought as a *derivative action*. Shareholders/investors can start such a suit on behalf of the corporation against its (previous) board members.[741] In starting a derivative suit, shareholders have to make a demand to the board, on which the board or a 'special litigation committee' formed for that purpose decides. The board itself thus has influence on bringing a derivative suit (§ 327 DGCL and §§ 7.40 – 7.47 MBCA; § 7.01 ALI Principles). The purpose is to foreclose 'frivolous actions'. Also, the board decision is protected by the BJR. If the action proceeds then the sued directors will also be protected by the BJR as well as by indemnifications[742] (art. 23 FRCP and Chancery Rule concerning the demand procedure).

In the UK, the derivative suit is regulated in secs. 260-264 UK CA 2006: 'A derivative claim only if there is a cause of action arising from an actual or proposed act or omission involving negligence, default, breach of duty or breach of trust by a director of the Company'. The court has to give its permission to start a derivative suit: sec. 261 (1) UK CA 2006, 'A member of a company who brings a derivative claim must apply to the court for permission to continue it'.[743]

Upon implementing the new EU securities regulation Germany introduced a derivative action (§§ 147-149 AktG) for the AG, also in comparison to the US and also the UK, with strict entrance requirements and safeguards, including through a German BJR (§ 93 (1) AktG) as introduced in 2005. The conditions as inserted in §§ 147-149 AktG aim at foreclosure of so-called 'strike suits'.[744] Germany codified the BJR in § 93 (1) AktG as previous accepted by the Bundegerichtshof[745] "*weiten unternehmerischen Handlungsspielraum*", without undertaking (stimulate entrepreneurial spirit) is not possible.[746] In the art. 2:9 NCC-procedure as in the investigation procedure (art. 2:345 NCC and further), these thresholds are lacking.

4.4.1 Recognition of Board supremacy and discretion: the BJR

Evidently, large-scale firms, organised as public corporations, like any large organisation irrespective its nature, form and activities, can only operate under a board (BoM/SB) with proper strategic and operational powers to govern the corporation and to represent it in its external relations in the market. This is no different in the organisation of issuers.[747]

741 This action and function are the research topic of the dissertations by M.J.Kroeze and B.F. Assink.

742 § 102 (b) (7) DGCL gives the corporation the power to amend their certificates of incorporation to eliminate or limit the personal liability of directors for monetary damages, with certain limited exceptions.

743 Gower and Davies, 2008, p, 605 ff. Cf. also John Armour, Benard S. Black, Brian R. Cheffins and Richard Nolan, 'Private Enforcement of Corporate Law: An Empirical Comparison of the UK and the US', *Journal of Empirical Legal Studies*, Vol. 6, 2009, pp. 687-722.

744 Cf. Ulrich Noack and Dirk Zetzsche, 'Germany's Corporate and Financial law 2007; (Getting) Ready for Competition', *CBC-RPS No. 0028,* June 2007.

745 BGH 21-04-1997 – II ZR 175/95 – "ARAG/Garmenbeck", BGHZ 135, 244, cf. Klaus Hopt in Großkomm. AktG, § 93Rz. 81; Hefermehl/Spindler in MunchKomm. § 93 Rz. 24 ff AktG; Kindler, ZHR 162 (1998), 101, 103 ff; Henze, NJW 1998, 3309, 2211; Assink, 2007 and SER-advies Evenwichtig Ondernemingsbestuur.

746 K. Schmidt, *Gesellschaftsrecht,* Heymans 2002, p. 815: „Nach § 76 (1) AktG hat der Vorstand die Gesellschaft unter eigenen verantwordung zu leiten, wobei ihm nach der sog. 'business judgement rule' ein unternehmerischer Ermessensspielraum zusteht".

747 Sven Dumoulin, 'De positie van niet-uitvoerend bestuurder in het monistisch bestuursmodel', *Ondernemingsrecht* 2005-8, p. 268.

The Berle & Means analysis supports that observation from the perspective of (dispersed) investors, though the more recent L&E 'agency theory' of investors as 'owners', together with the increased shareholder activism and regulatory extension of shareholders' rights seem to question that principle.

Nevertheless, the principle of supremacy and discretion being attributed to the board *in office* seems firmly vested in the jurisdictions discussed here. The board's core assignment in the examined jurisdictions is to decide on policy and strategy and monitoring the execution thereof.[748]

In comparising the statutory assignment and rules the following has been found: the position of and (core) assignment of the board of a (listed) public corporation are not fundamentally different in the US, UK, Germany or the Netherlands. It is appointed in that function and independently, thus without instructions of others, according to its own abilities and insight will give form and content to the entrepreneurial function of the corporation (legal entity), will determine strategy and policy and execute these with guiding and monitoring of its execution by the organization.[749] The BJR in the US and Germany confirms and protects this supremacy and discretion of the board.

In the US, the MBCA-principles[750] read as follows: § 8.01 (a), each corporation must have a board of Directors, § 8.01. (b), All corporate powers shall be exercised by or under the authority of, and the business and affairs of the corporation managed by or under the direction of, its board of directors, subject to any limitation set forth in the articles of incorporation or in an agreement authorised under § 1 7.32. The Delaware[751] DCGL expresses the supremacy and discretion of the board: § 141 (a) DGCL § 141 (a) DGCC: 'the business and affairs of every corporation organized under this chapter shall be managed by or under the direction of a board of directors.'[752] As stated before US issuers, most often based in

748 Reinier R. Kraakman, Paul Davies, Henry Hansmann, Gerard Hertig, Klaus J. Hopt, Hideki Kanda & Edward B. Rock, *The Anatomy of Corporate Law, A Comparative and Functional Approach*, New York: Oxford University Press 2004, p. 12, the board is formally distinct from the firm's shareholders. This separation economised on the costs of decision-making by avoiding the need to inform the firm's ultimate owners and obtain their consent for all but the most fundamental decisions regarding the firm.

749 Cf. Reinier R. Kraakman, Paul Davies, Henry Hansmann, Gerard Hertig, Klaus J. Hopt, Hideki Kanda & Edward B. Rock, *The Anatomy of Corporate Law, A Comparative and Functional Approach*, New York: Oxford University Press 2004, p. 12; Raaijmakers, *Ondernemingsrecht, Pitlo/Raaijmakers,* Deventer: Kluwer 2006, p. 390 and further; B.F. Assink, *De Januskop van het ondernemingsrecht,* Deventer: Kluwer 2010.

750 Cf § 4.01 ALI Principles of Corporate Governance (1994): According to the American Law Institute's (ALI's) Principles of Corporate Governance, a corporate director or officer is required to perform his or her functions 1) in a good faith, (2) in a manner that he or she reasonably believes to be in the best interests of the corporation, and (3) with the care that a ordinarily prudent person would reasonably be expected to exercise in a like position and under similar circumstances. The core of this standard is the level of care that we expect would be exercised by an ordinarily person

751 Bainbridge 2005, p. 7: "The corporation is properly understood as a legal fiction representing the nexus of a set of contracts among the multiple factors of production provided by the organization's various constituencies. Because shareholders are simply one of the inputs bound together by this web of voluntary agreements, ownership is not a meaningful concept as applied to the corporation."

752 It is conceptually important to establish that in the US/ Delaware remaining powers belong to the board § 141 (a); § 8.01 MBCA, whereas in the Netherlands system takes the reverse position as starting point; these powers belong to the GMS art. art. 2:107 NCC,

Delaware, use staggered boards which re-affirm board supremacy, also in case of hostile takeover attempts.[753]

In the UK, the UK CA 2006[754] leaves the determination of the role of the board and the level of independency and discretion largely to the company's constitution.[755] The UK model articles assume[756] the independency and discretion of the board and give substantial authority to the board, as illustrated by the default provisions[757] of Companies (Model Articles) Regulations 2008,[758] (UKCA (2006) § 20 (1)), arts. 3 and 4 MAPC[759] (see also Table A, art. 70[760]).

Germany. The principle of board supremacy and discretion was firmly vested in German corporate law for 'public' corporations (Aktiengesellschaft) in the Aktiengesetz as early as 1937 (Führer-prinzip). § 76 (1) AktG: the management board shall manage the company under its own responsibility (Der Vorstand hat unter eigener Verantwortung die Gesellschaft zu leiten).[761]

In the Netherlands, a statutory rule, besides art. 2:129 NCC that *only* states the corporation will be managed by the board, that expresses the supremacy and discretion of the board as

753 § 8.01(a) MBCA, each corporation must have a board of Directors, § 8.01. (b) MBCA, All corporate powers shall be exercised by or under the authority of, and the business and affairs of the corporation managed by or under the direction of, its board of directors, subject to any limitation set forth in the articles of incorporation or in an agreement authorized under § 7.32 MBCA.

754 See however § 154 UK CA 2006 requires all public companies to have two directors.

755 In the UK the division of powers as between board and the shareholders is seen as a matter for private ordering by the members of the company rather than something to be specified mandatorily in the companies legislation.

756 Subject to the provisions of the Act, the memorandum and the articles and to any directions given by special resolution, the business of the company shall be managed by the directors who may exercise all the powers of the company.

757 The function of a default rule is that the obligees can easily remove the obligation; the rule may nevertheless have the important function of relieving parties of the task of working out the best rule for themselves. Only if the particular parties want something different from that normally adopted will they have to go through the process of altering the rule.

758 Gower & Davies, 2008, p. 368, as far as the shareholders are concerned, for many years it was disputed whether the effect of the delegation of authority in the articles to the directors was simply to confer authority on the directors or also, at the same time, to restrict the authority of the shareholders in general meeting to take decisions in the delegated area.

759 See also Combined Code 2006, supporting principle A1, The board's role is to provide entrepreneurial leadership of the company within a framework of prudent and effective controls which enables risk to be assessed and managed. The board should set the company's strategic aims, ensure that the necessary financial and human resources are in place for the company to meet its objectives and review management performance. The board should set the company's values and standards and ensure that its obligations to its shareholders and others are understood and met.

760 Companies (Tables A – F) Regulations 1985 as amended by SI 2007/2541and SI 2007/2826, these are the temporary articles of incorporation. Table A, Regulations for management of a (public) company limited by shares. Subject to the provisions of the Act, the memorandum and the articles and to any directions given by special resolution, the business of the company shall be managed by the directors who may exercise all the powers of the company. No alteration of the memorandum or articles and no such direction shall invalidate any prior act of the directors which would have been valid if that alteration had not been made or that direction had not been given. The powers given by this regulation shall not be limited by any special power given to the directors by the articles and a meeting of directors at which a quorum is present may exercise all powers exercisable by the directors.

761 § 111 AktG, der Aufsichtsrat hat die Geschäftsführung zu überwachen and forward of the Deutscher Corporate Governance Code, The Management Board is responsible for managing the enterprise. Its members are jointly accountable for the management of the enterprise. The Chairman of the Management Board coordinates the work of the Management Board.

such is lacking. However, jurisprudence explicitly confirms that rule for the first time in the decision of the Supreme Court in the *Forumbank* case[762] and recently by the decisions of the Supreme Court in *ABNAMRO* and *ASMI*.[763] Therefore, a statutory rooted normative principle and point of departure recognising the discretionary powers of the board is lacking. Such a statutory starting point constitutes the foundation for the BJR in Delaware and Germany. In relation to judicial review of board's decision and the application of the BJR, it is not very clear in all of the examined systems whether board supremacy and board discretion is adhered to. However, US courts in breach of duty of care and loyalty cases will, in the first instance, put the board supremacy and discretion foremost. Therefore these important corporate principles of the board's authority are protected against fishing expeditions by plaintiffs and 'second guessing' by courts, who de facto review the complaint ex post and with hindsight. This will be the subject of par. 4.4.1.4 below. First, the position of the board as trustee and entrepreneur as filled in by their fiduciary duties of loyalty and care will be explained.

4.4.1.1 Board's position as trustee and entrepreneur: duties of loyalty and care

The second layer as introduced in par. 4.3 concerns responsibility and liability of (members of) the board *vis-à-vis the issuer* for damages incurred by the issuer itself and therefore, indirectly, by its investors. Enforcement may be used merely to compensate such loss (often from former board members), often in insolvency, but also as a means to put pressure on the board to change its strategy or position in a contested takeover. Such a suit can be brought derivatively, i.e. – if certain conditions are met[764] – also without the consent of the board in the US, UK and Germany. The Netherlands does not allow this, but the investigation procedure as previous explained may also be used as an alternative. Conceptually, such a derivative suit is based on the failure by (members of) the board (and, as the case may be, officers) to properly discharge their duties under the issuer's statute to direct and manage the issuer and its entrepreneurial activities (firm). Their position has a dual nature. They are both 'entrepreneur' and 'trustee'. Acting as an entrepreneur in a competitive environment is by its very nature risky (a 'venture') and requires 'entrepreneurial skills and spirit'. Acting as 'trustee' (with supremacy and discretionary power), requires proper prudence in the administration of the issuer's assets and activities, resistance of 'moral hazards' and abstaining from any (form of) self to enrichment. These two – in a certain way opposite, but also strongly interlinked – aspects over time directed the development and shape of statutory and case law on the liabilities of the board, its members and officers and the means for their enforcement.

762 Supreme Court 21-01-1955, *NJ* 1959, 43 (Forumbank); See also Raaijmakers, 'Forumbank Revisited', *AA* 2006, 522.

763 Supreme Court 13-07-2007, *LJN* BA7970 (takeover battle for ABNAMRO); *JOR* 2006/179; *AA* 2006 (with reference Raaijmakers); Enterprise Chamber 5-08-2009, *LJN* BJ 4688 (battle for strategic course ASMI), *AA* 2009, p. 734 – 743 (with annotation Raaijmakers).

764 American and German law here offer a double protection of the Board: a) Procedural by requirements for admission of the action and b) material by the business judgment rule. Cf. M.J. Kroeze, *Bange bestuurders*, Deventer: Kluwer 2005.

4.4.1.2 Fiduciary duties of care and loyalty

In private enforcement, a derivative suit will prevent the judiciary from 'second guessing' the board's business judgement, but they will review its non-observance of fiduciary duties. These duties are distinguished between duties of care (primarily focussing on the process of decision-making and seldom leading to liability) and duties of loyalty (focussing on decent 'non-selfish' behaviour as a 'trustee' and – if proved by the plaintiff – usually upheld in court). The content of these duties as supplemented by judicial review give direction to the board's assignment. These duties and the content thereof do not give a clear cut rule, however, they are standards that are filled in ex post. Director conduct will be reviewed in court and depending on how business decisions are assessed, judges will give more or less deterrence to board authority.[765]

In common law countries, such as in the US and UK, fiduciary duties as developed in case law play an important role,[766] although by now at least in the UK they have some basis in statutory law. In the UK, principal fiduciary duties have made their way into the UK CA 2006, Chapter 2 of Part 10, 'General Duties of Directors'.[767] As formulated by UK common law, fiduciary duties are owed to the company, see also § 170 (1) UK CA 2006. UK directors in general do not owe fiduciary duties to shareholders individually.[768] In the US and the UK, fiduciary duties (duties of loyalty, care and good faith) serve as a basis for board conduct and judicial review.[769] Fiduciary duty analysis traditionally focusses on the duties of care and loyalty and recently in the US also on the duty of good faith.[770] The duty of care sets the

765 Again the central theme is that authority and accountability of the board, depending on how the content of these duties are filled in, and how the business decisions are reviewed in court, judges will give more or less deterrence to board authority. (According to Sean J. Griffith, 'Good Faith Business Judgment: A Theory of Rhetoric in Corporate Law Jurisprudence', *Duke Law Journal*, Vol. 55, no.1, 2005, the context of applying and review of fiduciary duties, e.g. financial crises, (in Delaware federal pre-emption or corporate migration) influence the way the judiciary and legislation intervene in the balance of authority/accountability of the board.

766 Gower and Davies, Principles of Modern Company Law, Sweet & Maxwell, London: 2008, p. 477, the substantial corpus of learning on the nature and scope of these general fiduciary duties and duties of skill and care has remained until now largely within the common law. However with the enactment of the Companies Act 2006 these common law principles got a statutory basis.

767 Sec. 170 (3) and (4) UK CA 2006 say that the general duties replace the common law duties on which they are based. Consequently, in future any allegation of breach of duty by the director to the company needs to be identified as a breach of one or more of the general duties set out in the statute, except in so far as the statutory statement preserves, as it does in reaction to creditors 'interest, the common law duties. NB, there is no desire on the part of the legislature to cut the law of director's duties off from its historical roots in the duties applying to other persons acting in a fiduciary character.

768 Gower and Davies, *Principles of Modern Company Law*, Sweet & Maxwell, London: 2008, p. 480, this is different for fiduciary duties owed to shareholders which are dependent upon establishing 'a special factual relationship between the directors and the shareholders in the particular case'.

769 B.F. Assink, *Rechterlijke toetsing van bestuurlijk gedrag,* Deventer: Kluwer 2007, p. 264. Allen and Kraakman, 2003, p. 239, the first and most basic duty, sometimes called the duty of obedience, is that a fiduciary must act consistently with the legal documents that create her authority. Thus, a corporation's charter charges its director with certain tasks, such as holding an annual meeting on a fixed date, these directors *may* face liability for failing to do as they are asked, even if they act in good faith. However the discretionary power of the board as such is not eroded.

770 See *Cede & Co. v. Technicolor.* 634 A 2d 345, 367 (Del. 1993), 'Duty of care and duty of loyalty are the traditional hallmarks of a fiduciary who endeavours to act in the service of a corporation and its stockholders. Each of these duties is of equal and independent significance.' The court refers to Court of Chancery *van Delaware Lutz v. Boas* (Del Ch. 1961): 'Duty of care and duty of loyalty are the traditional

minimum quality threshold for managerial decisions at some benchmark standard such as for negligence or gross negligence.[771] The US duty of care requires the corporate fiduciaries, especially directors and officers, to act with 'the care of an ordinarily prudent person in the same or similar circumstances',[772 773] see ALI Principles of Corporate Governance. There are only a few cases that impose liability in case of breach of duty of care.[774 775] Regarding the preparation of a business decision, directors have a duty to inform themselves,[776] prior to making a business decision, of all material information reasonable available to them. Having become so informed they must then act with requisite care in the discharge of their duties[777] (well-considered and well-informed). The duty of loyalty is a proscription against director conflict of interest and self-dealing. The duty requires a corporate director, officer or controlling shareholder to exercise his institutional power over corporate processes or

hallmarks of a fiduciary who endeavours to act in the service of a corporation and its stockholders. Each of these duties is of equal and independent significance.'

771 As Reinier R. Kraakman, Paul Davies, Henry Hansmann, Gerard Hertig, Klaus J. Hopt, Hideki Kanda & Edward B. Rock, *The Anatomy of Corporate Law, A Comparative and Functional Approach*, New York: Oxford University Press 2004, p. 52 describes, the only standard that qualifies as a general instrument of corporate governance is the duty of care, which sets the minimum quality threshold for managerial decisions at some benchmark standards such as negligence or gross negligence. Defining and enforcing such a standard is notoriously difficult and, to our knowledge, is not done extensively anywhere for good reason: evaluating business decisions ex post is difficult, and legal error in imposing liability is likely to make directors overly risk adverse ex ante. The rare case in which the law appears to hold directors liable for negligent decisions without evidence of bad faith or self-dealing generally involves extraordinary and easily distinguishable circumstances that we consider in later chapters, such as a sale or merger of the entire company.

772 Despite its sweeping scope, however, the duty of care is litigated much less than the duty of loyalty, primarily because the law insulated officers and directors from liability based on negligence (as opposed to knowing misconduct) in order to avoid inducing risk-averse management of the firm.

773 Allen, Kraakman and Subramanian, *Commentaries and Cases on the Law of Business Organization (2*nd *Edition)*, New York: Aspen Publishers 2007, p. 242, from the beginnings of Anglo-American corporate law, courts have maintained that a corporate director must do more than pursue the corporations' interest in good faith, she also has the duty to act as a reasonable person would in overseeing the company's operations. Note 5, p. 242 Allen & Kraakman, *The Charitable Company v. Sutton*, 2 Atk. 400, 406 (Ch. 1742), 26 Eng. Reps. 642 (1742) and see, e.g. *Godbold v. Branch Bank*, 11 Ala. 191 (1847). *Hodges v. New England Screw Co.*, 1 R.I 312 (1850), *Bates v. Dresser*, 252 US 524 (1929) (Holmes, J.). It is notable that *Sutton* is not a case in which a loss resulted from a board decision, rather, it was a neglect of attention case. The cases of inattention, rather than poor judgment, are the case in which one would traditionally find directors liable for breach of care.

774 B. Assink 2007, p. 176.

775 Within the BJR the court can only review the preparation of a business decisin to the duty of care, not the content of that decision: process of duty of case

776 *Brehm v. Eisner* (Del. 2000), the standard for judging the informational component of the director's decision making does not mean that the board must be informed of every fact. The board is responsible for considering only material facts that are reasonable available, not those that are immaterial or out of the board's reasonable reach.

777 B. F. Assink, p. 186/196, *Aronson v. Lewis*, 473 A.2d 805 (Del. 1984), *Smith v. Van Gorkum* (Del. 1985), *The Walt Disney Company Derivative Litigation* (Del. Ch. 2005), *Hollinger, Inc. v. Hollinger International, Inc*. (del Ch.2004), *Cede & Co. v. Technicolor, Inc.*, 634 A.2d 345 (Del. 1993), also important to represent the court: in those decisions we have defined a board's duty of care in variety of settings. For example, we have stated that a director's duty of care requires a director to take an active and direct role in the context of a sale of a company from beginning to end. (Directors cannot be passive instrumentalities during merger proceedings.) In a merger or sale, we have stated that the director's duty of care requires a director before voting on a proposed plan of merger or sale, to inform himself and his fellow directors of all material information that is reasonable available to them.

property (including information) in a good-faith effort to advance the interests of the company.[778] In the US, the duty of loyalty is owed by the board to the corporation and its shareholders.[779] In the UK, the duty of loyalty is regulated in sec. 175 UK CA 2006 (see the annexes for an overview statutory law).
Apart from the UK (having a well-established and elaborate trust law), the distinction between duties of care and those of loyalty are not clearly distinguished in the EU and examined MS. For example, Germany § 93 (1) AktG: 'Die Vorstandmistlfieder haebn bei ihrer Geschäftsführung die Sorgfalt eines ordenrtlichten und gewissenhaften Geschäftsleiters anzuwenden'. Further German law provides a legal competition prohibition (§ 88 AktG); sec. 5.5 GCGK supplies some general rules in case of conflicts of interest. See also § 311 ff Konzernrecht addresses, among other things, the conflicts of interest that may arise in transactions between a corporation and its controlling shareholder.
In the Netherlands, the board's assignment is (cf. also art. 2:140 (2)) substantiated in case law by interpreting art. 2:8 NCC (reasonable and fairness) and art. 2:9 (internal liability).[780] The substantiation of open norms as art. 2:8 NCC (reasonableness and fairness) by the Enterprise Chamber at least in part was achieved by accepting 'self-regulating' governance rules of the NCGC. As discussed above, director conduct in an investigation procedure is not directly reviewed in the face of the general rules of arts. 2:8 and 2:9 NCCC[781]. However, in the application of the open norm of equity (art. 2:8 NCC), the Enterprise Chamber used its interpretational freedom to adopt norms of 'good governance'.[782]
In summary: duties of care are linked to the concept that entrepreneurial decisions of the board should be well-informed and well-considered. Translate this into 'not recklessly' and the connection with the entrepreneurial basis and therefore also with the business judgement (rule) is revealed. These duties in fact build on the internal statute of issuers, more particularly on the procedures for decision-making.[783] Some of these duties are regarded

778 Allen, Kraakman and Subramanian, *Commentaries and Cases on the Law of Business Organization(2*nd *Edition)*, New York: Aspen Publishers 2007, p. 285 and Hamilton 2000, 467 and Klein, Ramseyer and Bainbridge, Business Associations, cases and materials on agency, partnerships and corporations, 2006, p. 374. Stated negatively, the duty of loyalty requires such a person who transacts with the corporation to fully disclose all material facts to the corporation's disinterested representatives and to deal with the company on terms that are intrinsically fair in all respects.
779 B.F. Assink, Rechterlijke toetsing van bestuurlijk gedrag, Deventer: Kluwer 2007, p. 150.
780 See Raaijmakers, *Ondernemingsrecht, Pitlo/Raaijmakers,* Deventer: Kluwer 2006, p. 397. See also *Stork*- and *ABNAMRO*-cases.
781 Raaijmakers 2006, It should be noted that very significant effects of corporate reasonableness and fairness have been developed in the context of case law by the Enterprise Chamber. Moreover also, except specific rules for eacht of the forms of reorgaqnization, in Dutch law how in these particular circumstances art. 2:8 NCC has to be interpreted plays an important role: the general standard of reasonableness and fairness that applies to all private law legal entities. Two functions are distinguished: the supplementary working and the restrictive working of reasonableness and fairness. The first is particularly important in real 'closed', i.e. personal relationships. However in case of a formally legitimized decision of X to consolidate a public offer as a capital transaction the emphasis necessarily relates to a possible restrictive working. Case law does not make the aformentioned difference very clear. Art. 2:8 NCC provides, generally speaking, no basis to force a positive action of Y. However, that provision offers – 'passive though' – a basis to rescind ex art. 2:15 NCC a decision already taken; in general, therefore, a restrictive working.
782 Raaijmakers, 2006, p. 398.
783 See e.g. the famous US case *Smith v. Van Gorkum.*

as so important that they are enacted, such as the certification procedure in §§ 302 and 906 SOx. This also illustrates the focus of the worldwide corporate governance debate of the last decade on strengthened monitoring by the board (NED/SB), the independence of NED and SB-members especially of their audit, nomination and remuneration committees and of the requirement for the isuuer of 'being in control'. In the US, as already mentioned, the aforementioned requirements merely underpin accurate non-misleading disclosure of information by the issuer to the market. They connect in general with the requirements of US *securities regulation* that requires every reporting company to make and keep books, records and accounts that accurately and fairly reflect the issuer's transactions.[784] When these disclosures by the issuer are misleading they will be prosecuted amongst other things by a securities fraud action (Rule 10b-5 SEA'34). Connected but distinct is the US duty of the board to exercise oversight (Delaware Chancery Court In re Caremark International, Inc. Derivative Litigation)[785]. In that contect also duty of oversight has to be noted.[786] [787] This duty is part of the duty of care and as such requires that information and reporting systems exist that allow the board (BoM/SB) to reach informed judgments concerning both the corporation's compliance with law and its business performance.[788]
In the EU (examined MS) many principles and best practices in governance codes can be regarded as 'codifying' such duties of care (such as Best Practise II.1 DCGC, 'The management board is responsible for complying with all relevant primary and secondary legislation, for managing the risks associated with the company activities and for financing the company. The management board shall report related developments to and shall discuss

784 Allen, Kraakman and Subramanian, *Commentaries and Cases on the Law of Business Organization(2*nd *Edition)*, New York: Aspen Publishers 2007, p. 281 in the matter of Michael Marchese, p. 280, Subra Section 13 (b) (2)(A) of the SEA'34 requires every reporting company to make and keep books, records and accounts that accurately and fairly reflect the issuer's transactions. Section 13 (b) (2) (B) requires a company to devise and maintain a system of internal controls sufficient to provide reasonable assurances that transactions are recorded as necessary to permit the preparation of financial statements in conformity with GAAP.

785 In *re. Caremark International Inc. Derivative Litigation* (Del. Ch. 1996), the *Caremark* decision is rightly seen as a prod towards the greater exercise of care by directors in monitoring their corporation's compliance with legal standards.'

786 Allen/Kraakman, p. 269, boards of public companies have a particular obligation to monitor their firm's financial performance, the integrity of its financial reporting, its compliance with the law, its managemnet compensation, and its succession planning.

787 Allen, Kraakman and Subramanian, *Commentaries and Cases on the Law of Business Organization (2*nd *Edition)*, New York: Aspen Publishers 2007, p. 263, the BJR rule protects boards that have made decisions. In fact, however, the relatively few cases that actually impose liability on directors for breach of the duty of care are not cases in which a decision proved disastrously wrong but cases, like the Enron collapse of 2001, in which directors simply failed to do anything under circumstances in which it is later determined that a reasonably alert person would have taken action.

788 B.F. Assink, *Rechterlijke toetsing van bestuurlijk gedrag,* Deventer: Kluwer 2007, p. 184, recently the reasoning by Chancellor Allen in *In re. Caremark International, Inc. Derivative Litigation* has been confirmed by the Supreme Court of Delaware, Justice Holland considers: 'It is important, in this context, to clarify a doctrinal issue that is critical to understanding fiduciary liability under Caremark as we construe that case. The phraseology used in Caremark and that we employ here, describing the lack of good faith as a 'necessary condition to liability' is deliberate. The purpose of that formulation is to communicate that a failure to act in good faith may result in liability because the requirement to act in good faith 'is a subsidiary element (,) i.e. a condition, 'of the fundamental duty of loyalty'. It follows that because a showing of bad faith conduct, in the sense described in Disney and Caremark, is essential to establish director oversight liability; the fiduciary duty violated by that conduct is the duty of loyalty.

the internal risk management and control systems with the supervisory board and the audit committee'[789]). Strictly speaking they are not enforceable, but neither are they irrelevant.
Duties of loyalty, on the other hand, refer directly to the core of the 'truste-like' position of board members. Statutory rules cover, inter alia, duties to disclose conflicts of interest and related party transactions, incompatibilities, limits to representation of the corporation, non-competition clauses for board members and officers. Many principles and best practices in codes also are directed at loyalty, e.g. Best Practise II.3 DCGC Conflicts of interest, Principle: 'Any conflict of interest or apparent conflict of interest between the company and management board members shall be avoided. Decisions to enter into transactions under which management board members would have conflicts of interest that are of material significance to the company and/or to the relevant management board member require the approval of the supervisory board'.

4.4.1.3 Purpose and nature of the BJR in further detail
The BJR obviously does not provide 'carte blanche' to make the board invulnerable. The fiduciary position (see par. 6.4.1) of the board according to its appointment and assignment alse means that the board has to execute it adequately (according to its fiduciary duties as prescribed in the US and UK) and account for it in the prescribed manner to the corporation, that is to say towards its supervisors (SB/NED) and the GMS, and not to abuse its position, not to intertwine its interests and absolutely not to enrich itself.[790] As explained in the previous paragraph this concerns the fiduciary duties of care, loyalty (and good faith).
If the strategy and policy of the corporation (board) does not deliver the success as expected by investors and the market, the greatest danger lies in the fact that the board (members) in a liability suit will be condemned because the court with wisdom of hindsight ('*hindsight bias*') and insufficient expertise places its own judgement on what the board (members) as entrepreneurs should have done better. Board members want to be indemnified from that risk and to that effect serve not only (statutory) *indemnification* and *D&O-insurance*, but especially the BJR.[791] This prevent 'risk aversion' to the detriment of the corporation, its

789 Best Practise III.8.1 DCGC, requirement for the SB to discuss strategy of the corporation; Best Practise III.1.9 DCGC requirement for SB to require all relevant information from the management; Best Practise II.1.3 DCGC The company shall have an internal risk management and control system that is suitable for the company. It shall, in any event, employ as instruments of the internal risk management and control system: a) risk analyses of the operational and financial objectives of the company; b) a code of conduct which should be published on the company's website; c) guides for the layout of the financial reports and the procedures to be followed in drawing up the reports; and d) a system of monitoring and reporting.

790 Cf. § 21 UMAG: 'Die Regelung geht von der Differenzierung zwischen fehlgeschlagenen unter nehrneischen Entscheidungen einerseits und der Verleizung sonstiges-Plichten andererseits (Treuep flichten; Infomiationspflichten; sonstige algemeine Gestetzes- und Salzungsverstdlle) aus. Em VerstoB gegen diese Jetztere Pflichtengruppe ist von der Bestimmung nicht erfasst. Die untemehmerische Entscheidung steht im Gegensatz zur rechtlich gebundenen Entscheidung. Fur illegales Verhalten gibt es keinen "sicheren Hafen" im Sinne einer haftungstatbestandlichen Freistellung, es kann hier nu Einzelfall aber aan Verschulden fehien.'

791 Cf. also M.J. Kroeze, *Bange bestuurders*, Deventer: Kluwer 2005; B.F. Assink, *Rechterlijke toetsing van bestuurlijk gedrag,* Deventer: Kluwer 2007; ALI Principles of Corporate Governance, ad § 4.01: 'The drafters justify the business judgment rule as being necessary to protect "directors and officers from the risks inherent in hindsight reviews of their business decisions" and avoid "the risk of stifling innovation and venturesome business activity."' Cf. William A. Klein & John Coffee Jr., *Business Organi-*

investors, other interested parties and the society as a whole. That danger is turned by the BJR: in its judgement, the court will honour the *business judgement* of the board, will refrain from judging with wisdom of hindsight and will not place its own judgement instead of the board (will not sit on the 'chair' of the board). In that way the board's supremacy and discretion will be protected.

The Delaware Supreme Court considered: 'Under Delaware law, the business judgment rule is the offspring of the fundamental principle, codified in § 141(a) DGCL, that the business and affairs of a Delaware corporation are managed by or under its board of directors... The Business judgement rule exists to protect and promote the full and free exercise of the managerial power granted to Delaware directors.' Bainbridge summarises this rule: 'to protect and promote the full and free exercise of the managerial power granted to Delaware directors'.[792] Compare also ABA Corporate Director's Guidebook: 'Where it is said that a decision constitutes a valid business judgment (and gives rise to no liability for ensuing loss) when it 1) is made by financially disinterested directors or officers 2) who have become duly informed before exercising judgment and 3) who exercise judgement in a good-faith effort to advance corporate interests.'[793]

zation and Finance, New York: Foundation Press 2002, p. 258-60: "Another explanation for the BIR is that judges are no business experts", see *Dodge v. Motor Co*, 170 N.W. 668 (Mich. 1919). Allen, Kraakman and Subramanian, *Commentaries and Cases on the Law of Business Organization (2*nd *Edition)*, New York: Aspen Publishers 2007, p. 256: "Without a certain rule directors who risk liability for making unreasonable decisions, would likely behave in a risk-averse manner that also harms shareholders." Cf. *Aronson v. Lewis*, 473 A2d 805, 812 (Del 1984), "the rule creates a presumption that the directors of officers of a corporation acted on an informed basis, in good faith, and in the honest belief the action was in the best interest of the company. The BJR is also in the shareholders' economic interest to offer sufficient protection to directors from liability for negligence" (...), "to allow directors to conclude that, as a practical matter, there is no risk that, if they act in good faith and meet minimal procedural standards of attention, they can face liability as a result of a business loss". In similar sense legislative history of the German UMAG; cf. B.F. Assink, *Rechterlijke toetsing van bestuurlijk gedrag,* Deventer: Kluwer 2007, p 429; see also § 8.31 (a)(2) MBCA: "directors are not liable to the corporation or its shareholders for any decision, unless, challenged conduct consisted or was the result of i) action not in good faith; or (ii) a decision (A) which the director not reasonable believe to be in the best interest of the corporation, or (B), as to which director was not informed to an extent the director reasonably believed appropriate in the circumstances; or (iii) a lack of objectivity due to the director's self-interest. (iv), a sustained failure of the director to devote attention to ongoing oversight of the business and affairs of the corporation (v), receipt of financial benefit to which the director was not entitled or any other breach of director's duty of loyalty".

792 *Smith v. Van Gorkum*, 488 A 2d 858, 872 (Del. 1985). Cf. Bainbridge 2002, p. 267.

793 Cf. Allen, Kraakman and Subramanian, *Commentaries and Cases on the Law of Business Organization(2*nd *Edition)*, New York: Aspen Publishers 2007, p. 255, in some formulations (like ALL, Corporate Governance Project § 4.01 (c) (1994)), it is also said that the business judgment rule does not protect 'irrational' or 'egregious behaviour'. However, we interpret this additional stricture as a restatement of the requirement that directors must act in good faith to enjoy the protections of the business judgment rule. Since the law cannot order directors to make correct decisions by flat, It follows, in our view, that disinterested directors who act deliberately and in good faith should never be liable for a resulting loss, no matter how stupid their decisions may seem ex post. Cf. Bainbridge 2002: The good faith and disinterested independence of the directors also are often identified as constitutions on which the rule is predicated, see, e.g. *Auerbach v. Bennet*, 393 N.E.2d 994, 999 (NY 1979), so long as directors were disinterested and acted in good faith, the business judgment rule required the court to defer to board committee's recommendation to dismiss a shareholder derivative suit.

The plaintiff has to state and prove that the presumption that the board acted in a *well-considered*, *well-informedway and in good faith* is false.[794] Therefore he has to proof that the board acted fraudulently/illegally, or was influenced by a conflict of interest or the decision did not serve any rational purpose or is a breach of the 'process of due care' (*a rational and good faith decision-making process).* That obligation to state facts and the burden to prove them combined with limited possibilities for discovery make it difficult to attack the BJR.
Similarly § 93 (1) AktG: 'Die Vorstandsmitglieder haben bei ihrer Geschäftsführung die Sorgfalt eines ordentlichen und gewissenhaften Geschäftsleiters anzuwenden', however sub 2 adds: *"Eine Pflichtverletzung liegt nicht vor wenn das Vorstandsmitglied bei einer unternehmerischen Entscheidung vernünftigerweise annehmen dürfte, auf der Grundlage angemessener Information zum Wohle der Gesellschaft zu handelen."* The German legislator operates the same notion: avoidance of risk-averse behaviour.[795]

4.4.1.4 BJR: material and procedural safeguards

The sued director (BoM/SB) will not be liable in the 'liability-free zone', which stops where the plaintiff proves that the board members had a conflict of interests, were not sufficiently informed, or could not reasonably be said to have acted in the interests of the corporation.[796] This does not entail a marginal test in which the court judges the board's policy; however only restrictively.
The BJR is also the point of departure in the first (demand) phase of a *derivative suit.*[797] To file such a suit the board first authorised.[798] The plaintiff has to file a demand with the board, before he can go ahead with this action in court.[799] The board's decision on demand will be protected by the BJR. In most cases this demand will be met and the plaintiff will address the court directly, stating that a 'demand' is unnecessary: '*futile*' or '*excused*'. This will succeed if a majority of the board in taking that decision had a conflict of interests, was not independent or reasonable doubt exists that the BJR does not apply for the challenged actions because of breach of the duty of loyalty or reasonable doubt exists that the BJR-

794 Or as De Wulf, 2002, p. 476 describes: 'No matter what decision of the board (BoM) it has to be examined whether the board acted subjectively in good faith, informed, and rational. That three-way test is, as seen in general, a test of the duty of care. However when a director has nevertheless an economical interest in that decision, then a further test has to be executes, namely a loyalty test: has the decision making been independent.'
795 The explanation with the UMAG states: "Eine untemehmerische Entscheidnng beruht häufig auch auf Instinkt, Erfahrung, Phantasie und Gespür for künftige Entwicklungen und einem Gefühl für die Märkte und die Reaktion der Abnehmer und Konkurrenten. Dies lässt sich nicht vol1ständig durch objective Informatjon ersetzen." Cf. B.F. Assink, 'Enige beschouwingen over Duitse ontwerpwetgeving, de Amerikaanse "business judgment rule" en ontwikkelingen in het Nederlandse vennootschapsrecht', *Ondernemingsrecht* 2005-10 and B.F. Assink, 'De Mannesmann-zaak, Een verhaal over irrationeel gedrag, hoogmoed en de bijbehorende val', *Ondernemingsrecht* 2006, p. 50 ff.
796 De Wulf 2002, p. 479.
797 Bainbridge, 2002, p. 269; cf. R. Franklin Balotti & James J. Hanks, jr., 'Rejudging the Business Judgment Rule', 48 Bus. Law. 1337, 1345, 1993. "Given the significant virtues of discretion, however, one must not lightly interfere with management or the board's decision making authority in the name of accountability. Preservation of managerial discretion should always be the *null hypothesis.* The separation of ownership and control mandated by US corporate law has precisely that effect. Likewise, the business judgment rule exists because judicial review threatens the board's authority."
798 § 141 (a) DGCL; § 76 AktG.
799 Art. 23 Chancery Rule and art. 23.1 Federal Rules on Civil procedure.

boundary has been crossed.[800] The fact has to be stated with 'particularity' without a right for discovery.[801] The plaintiff will base his claim mainly on disclosure documents (annual, semi-annual and quarterly accounts as filed with the SEC) and other external sources. These high thresholds try to prevent 'fishing expeditions' and 'frivolous actions'. Once they are met, then the derivate suit will start. In that procedure again the BJR will be taken as the starting point. Although the plaintiff does not have to attack that rule immediately, he has little chance if he has a real case.[802] The procedural and material meanings of the BJR are thus interwoven.[803] This also respects in principle the independence of the board (board supremacy) as well as the discretion of the assignment given to the board (board discretion) and prevents '*second guessing*' by the court that – by definition in retrospect – judges the claim. '*Fishing expeditions*', aimed at 'discovery', and also intervening through immediate measures (injunctions; orders by the court) will be stopped. The Delaware legislator and court also place the BJR clearly in the context of pervasion and stimulation of business climate.[804]

4.4.1.5 BJR and hostile takeovers

Because board supremacy and discretion in the case of (an attempted) hostile takeover specifically play an important role, and in relation to the Netherlands, have led to a series of Chamber of Business decisions (*RNA*, *Stork*, *ABNAMRO*, *ASMI*), Delaware corporate law will briefly be analysed. In this paragraph, I have limited myself, not only because of a lack of space, but also cause of the fact that Delaware corporate law is the most clear example of a system in which the board can defend the corporation as a 'bastion' against possible attacks.[805]

800 See the famous case of *Aronson v. Lewis*, which B.F. Assink, *Rechterlijke toetsing van bestuurlijk gedrag,* Deventer: Kluwer 2007, analyses in chapter 2.

801 Art. 23.1 Federal Rules of Civil Procedure and art. 11 Chancery Rule; cf. B.F. Assink, *Rechterlijke toetsing van bestuurlijk gedrag,* Deventer: Kluwer 2007, p. 122; see however § 220 DGCL: limited inspection of books and records.

802 Cf. B.F. Assink, *Rechterlijke toetsing van bestuurlijk gedrag,* Deventer: Kluwer 2007, p. 132; M.J. Kroeze, *Afgeleide schade en afgeleide actie,* Den Haag: Kluwer 2004, p. 202: "to put it strongly: if the court finds the claim weak by its substance, then the procedural obstacles are unassailable, if the court finds the claim strong, then these rules are no problem."

803 See *Aronson v. Lewis* (Del. 1984): "the function of the business judgment rule is of paramount significance in the context of a derivative action. It comes into play in several ways, in addressing demand, in the determination of demand futility, in efforts by independent disinterested directors to dismiss the action as inimical to the corporation's best interests, and generally, as a defence to the merits of the suit. However, in each of these circumstances there are certain common principles governing the application and operation of the rule". Cf. also B.F. Assink, *Rechterlijke toetsing van bestuurlijk gedrag,* Deventer: Kluwer 2007, p. 111.

804 It is illustrative that the threat of the well-known case in *Smith v. Van Gorkum* quickly was countered by § 140 DGCL; cf. also B.F. Assink, *Rechterlijke toetsing van bestuurlijk gedrag,* Deventer: Kluwer 2007, p. 456.

805 See for an extensive overview of the role of the board in case of a hostile take over: M.J. van Ginneken, *Vijandige overnames, De rol van de vennootschapsleiding in Nederland en de Verenigde Staten*, Deventer: Kluwer 2010, p. 483, stating that a rough distinction can be made between two basic models relating to the role of the board of the target company. The first model places the decisions regarding the outcome of a hostile takeover entirely in the hands of the shareholders of the target company and sidelines the board. The board should remain passive. In the second model the board has an active role. It acts as a gatekeeper an may take defensive measures to fulfil its role. As a result, shareholders are

In the case of a creeping hostile takeover, the target board (US) has a gate-keeping function.[806]
Although taking protective measures (poison pill, sale of assets, transaction with a 'white knight') the target-board cannot simply qualify as '*interested director transactions*' (§ 144 DGCL), the target's board members in that situation also simply qualify as independent, as in case of a successful bid they can lose their function.[807] That is the reason the Delaware courts have adjusted the BJR if investors claim that the target board's members have breached their fiduciary duties in defending the corporation against a hostile takeover.[808] It hovers between two extremes: a) the assumption by the BJR that they are disinterested/independent,[809] and b) that that assumption has been disproved and the target-board members have to abstain from any action that could interfere with the takeover (cf. the UK neutrality rule of the UK City Code). I will just briefly sketch the result. If a target board takes protective measures against a hostile tender offer, then it has to show that they in '*good faith and after reasonable investigation*' could view the threat as danger to corporate *policy and effectiveness*.
The test of *Unocal* was (i) whether the board may reasonably judge that the hostile tender offer forms a threat to the entity of the enterprise and (ii) whether the protective measures taken were reasonable in relation to the threat. In *Revlon* this test was refined if the board concludes that the sale is inevitable or the board itself puts the corporation up for sale or takes action for a merger with a white knight, a leveraged buy-out or a total sale of assets. In these cases they have to strive for the highest price for the shareholders. In the meantime – over and above '*Revlon*-situations' – the main rule of *Paramount v. Time* and *Paramount v. QVC* of the board to 'just say no', still stands.[810] Of course, as has been describe in chapter 3, control can also be gained by replacement of board members through a proxy contest. Then the securities proxy rules play a profound role. Thus a new board could rescind a poison pill. In *Unitrin v. American General Corp*.[811] the court decided that as long as the board could be replaced by a proxy contest, the target-board may take protective measures. However, the shareholder's rights to convene a special meeting is often lacking, so that the bidder could has to wait for coming elections to execute a proxy contest. Also, over 60% of listed public

unable to determine the outcome of the bid is not supported by the board. In practise, this means the bid must be accepted by both the board and the shareholder. In practise, this means the bid must be accepted by both the board and the shareholders. The manner in which the board fulfils its role may be reviewed by the courts. In the US, board passivity has explicitly been rejected by the Delaware Supreme Court. The board is expressly permitted to take defensive measures against a hostile takeover. Clearly, the US has opted for the second model.

806 Stephen M. Bainbridge, 'Unocal at 20: Director Primacy in corporate takeovers', *University of California, Los Angeles School of Law, Law & Economics Research Paper Series NO. 05-19*, September 2005, p. 3.

807 Christian Kirchner and Richard W. Painter, 'Towards a European Modified Business Judgment Rule for Takeover Law', *European Business Organizations Law Review* 2000, p. 13.

808 Christian Kirchner and Richard W. Painter, 'Towards a European Modified Business Judgment Rule for Takeover Law', *European Business Organizations Law Review* 2000, and Stephen M. Bainbridge, 'Unocal at 20: Director Primacy in corporate takeovers', *University of California, Los Angeles School of Law, Law & Economics Research Paper Series NO. 05-19*, September 2005 and B. Assink 2007.

809 See B. Assink, 2007, for further filling in of these norms.

810 M.J. van Ginneken, Vijandige overnames, De rol van de vennootschapsleiding in Nederland en de Verenigde Staten, Deventer: Kluwer 2010.

811 651 A 2d 1361 (Del.1995).

corporation make use of 'staggered boards', in which only a part will put themselves up for elections (§ 141 DGCL). Acquiring effective control in that way can take several years. A poison pill in combination with staggered boards offers effective protection against a hostile takeover.[812]

4.5 Again: comparison with the Dutch investigation procedure

Whatever may be the final outcome of the draft Bill to amend the investigation procedure, its impact on the Dutch business climate for issuers cannot be ignored and requires analysis and assessment, particularly its use as quasi-liability suit or a means to press for a settlement, even without completion of the procedure or subsequent liability procedure. [813] Such assessment should properly observe the differences that were already discussed above and may be briefly summarised as follows.

The investigation procedure lacks the usual procedural safeguards of a liability suit in which the claimant has to state facts and has the burden of proof, parties will be heard and have to follow the sequence of exchanging written statements (of claim and of defence). Somewhat comparable to 'demand' and 'Vorferfahren' is the requirement of art. 2:349 NCC to get access to the procedure: require petitioners shall inform the board of their complaints in order to allow the issuer a grace period for proper reaction. However, this requirement became practically obsolete and therefore does not function as *demand* or *Vorferfahren.* Similar protection is missing in case of granting immediate injunctive relief *even without* a judgement on admission to the procedure. Nevertheless, such initial judgements often contain, although an investigation report is not yet available, already 'qualifies' the behaviour of the board without the reluctance of a BJR. Both in interim and final decisions, the Enterprise Chamber uses (dis)qualification as 'improper governance', that is difficult to distinguish from the grounds of a art. 2:9 NCC-liability procedure ('improper governance') or of the receiver in bankruptcy on art. 2:138 NCC ('*obvious* improper governance').

As stated above, the explanatory notes to the draft Bill to amend the investigation procedure observe 'that there are no fundamental problems with the temporary system, however the right of investigation can be ameliorated in some details' and rejects the proposed BJR to lift the threshold for entry to the procedure and for the final judgement to be 'mismanagement of the corporation'. This statement seems to disregard the previous analysis in its application for issuers now having to adhere to the new securities law as well as its possible impact on jurisdictional arbitrage.

Shortly before finishing this study (1-9-2010), the Netherlands Supreme Court rescinded the Enterprise Chamber's decision in the *ASMI*-case. This decision is of utmost importance for further development. It therefore requires proper attention. Before summarising that

812 Zie Bebchuk/Ferrell 2001: Bebchuk represents a goup of US academics who plea for a more inluential role of shareholders in the listed public corporation.

813 With the short comment that if the Enterprise Chamber's decision of 5-07-2010 (*KPN/Qwest*) is not appealed to the Supreme Court, the applicant ('plaintiff') cannot offer the withdrawal of the request for an inquiry without permission of the Enterprise Chamber, which can, as it turned out, decide differently 'in the public interest'.

decision in par. 4.7.3. I shall continue my summary of the distinct elements of the investigation procedure.

4.6 Restructuring and restoration of sound relation in a listed public corporation (N.V.)

The comparative analysis also seems to support the hypothesis that the investigation procedure's objective of restructuring and restoring 'sound relations' in an issuer does not fit. The point of departure for an issuer going public, as discussed in chapter 3, remains its freedom to structure its internal affairs as it think fit for its organisation, observing of course the limits set by mandatory law.[814] This includes the division of tasks and powers between the board (BoM/SB) and the GMS, oligarchic regulations, anti-takeover devices and the rights connected to its securities (shares): voting, dividends and liquidation rights. The prospectus to be disclosed shall explain all this in proper detail; including adherence to the DCGC (comply or explain). Thus, investors are adequately informed and by accepting the offer also accept the issuer's internal governance. Board members are collectively assigned to manage the corporation and its undertaking under oversight of the SB/NED and to guide it and independently determine its strategy and policy. A division of tasks is usual (CEO, CFO and other officers). They shall act in the interest of the issuer and its business which also underscores their independence (supremacy).[815] They shall account to the GMS, which decides on their appointment and dismissal. To the market and its investors they are required to adhere to the rule of 'full disclosure' as prescribed by EU/Dutch securities regulations. Enforcement of investor's collective and individual rights as attributes by statute, articles of incorporation and bylaws *as shareholders* will follow the law and articles of incorporation:[816] voting and information rights in the GMS, reception of dividends, but also by buying and selling ('Wall Street Walk') on the exchange or offering their shares to a offeror in a public bid. Decisions can be rescinded ex post through art. 2:15 NCC rescission action (see par. 3.4 for similar actions in the other jurisdictions), however they cannot be enforced *ex ante*. Investors may collect/solicit other proxies or together call a GMS and – unimpeded (art. 2:114a NCC) – propose items for its agenda on matters within the competence of the GMS. Major decisions (such as sale of all assets) require the approval of the GMS, but a decision on adhering to the NCGC does not have the character of an amendment of the articles of incorporation that needs the approval of the GMS.
In their capacity as investors they are protected by mandatory securities law (AFS): initially by the strict disclosure and transparency rules for the offering circular and prospectus and subsequently by ongoing and *continuous* AFS disclosure requirements: annual reports,

814 See also Dutch Supreme Court, *LJN* BM0976 (ASMI), 4..4.2 under (iv).
815 Cf. M. Blair and Lynn. A. Stout, 'A Team Production Theory of Corporate Law', *Virginia Law Review, Vol. 85, No. 2,* 1999, p. 248-328.
816 Important to these shareholder's rights are when and on which grounds can one convene an annual GMS or special GMS, place items on the agenda and which quorum criteria apply for topics on which shareholders are authorised to decide, see chapter 3, par.

semi-annual, quarterly, and interim information.[817] Public supervision on enforcement of the securities regulation assigned to the AFM means: preceding approval for issuing and bidding (public takeover) prospectuses (art. 5:6 ASF), supervision on continuous disclosure, including the annual reports (art. 5:25a ASF), *restatement* (art. 2:445 ff. NCC)[818] and oversight on rules to be observed in public (takeover) bids (art. 5:70 ASF). The borderlines between the competence of the AFM and the Enterprise Chamber are not clear. The issuer as a corporation (NV) will go public "as is" in an IPO. The assessment by the market, analysts and investors of the IPO will cover the value of the securities in the offer, the market position, its products, services, innovative power, 'past performance', future expectations and success, as well as confidence in its board (especially the CEO and CFO) and its supervisors (SB-members or NEDs).
Investors evidently have great interest in the issuer's performance, but investing is not the same as managing. Trust in the board's entrepreneurship and strategy remains essential and the securities law disclosure and transparency rule will allow ongoing monitoring by the market and investors. Loss of trust will cause pressure to replace the CEO and/or board members and adapt the strategy and policies. The SB or NEDs are best suited for that. The GMS as such is utterly unsuitable for taking such actions. Investors remain free to trade their shares and disinvest, but also to stay on and to voice their criticism of board performance. Analysts, the financial press, rating agencies and voting advisors play a very important role in continuous assessment of that performance and its reflection in the stock price and the issuer's reputation and disciplining the board (cf chapter 2, par. 2 on that monitoring function of the market).
This short analysis may already illustrate the difficulties in addressing 'insane internal relations' in court by means of allowing entry to the investigation procedure and by subsequent immediate and/or final specific injunctions and to balance these with the issuer's interest in undisturbed pursuance of its ongoing business and activities and prevention of exposure to reputational damage.

4.6.1 Unsound relations in issuers?

The most simple ground would be that the issuer violated organisational rules (internal affairs) provided by statute and/or the articles of incorporation (US = bylaws, UK = articles), although that leaves open the question of whether and to what extent that already constitutes 'insane' and 'restorable relations'. However, the key test remains the board's supremacy and discretion with respect to the issuer's strategy and policies. Not surprisingly, the Enterprise Chamber repeatedly paid lip service to that principle. Subsequently, however, it

817 I refer to ch. 2. By that the ASF implemented the European system in protecting investors in the market (Prospectus, Admission, Transparency, and Market Abuse Directives, the IAS Regulation (IFRS), the 8th Directive that does not fit well, and, rules of conduct in case of public biddings (TD). Everything under preventative and repressive public supervision by the AFM. Cf. also Raaijmakers/Van der Schee (2008) (reference 5).

818 The enforcement (private law) of art. 2:101 (3) NCC, the authority for listed public corporations of the GMS to adopt the annual accounts, suggests an intra-corporate enforcement of the disclosure obligation of annual reports as required by the FSA. In our view, this as well as the dependency of the restatement action of the AFM (art. 2:447 NCC) on that adoption of the annual accounts, in the new structure of the securities law this is an anomaly.

effectively created new organisational rules in the issuers' internal affairs, most often by extensive interpretation of the general standards of art. 2:8 NCC (reasonable and fairness, discussed in chapter 3), allowing a breach of these rules so 'created' to be determined. As stated above these include: a) extensive application of art. 2:107a NCC in the *LaSalle*-transaction *(ABNAMRO*[819]; cf. chapter 3.3.9.1); b) the 'duty' of (continued) dialogue with investors *(Enterprise Chamber 17-01-2007, JOR 2007, 47 (Stork));* c) the duty of the SB to 'negotiate' and mediate *(Stork, ASMI);* d) the limitation of time to respond to a hostile takeover attempt *(Stork)*; e) 'enforcing' soft law NCGC-best practices on board-composition and to extend these to a subsidiary *(Versatel)*[820]; f) qualification of a white knight foundation as 'shadow director' *(ASMI)*; g) extension of duties to consult the GMS *(HBG*, *ABNAMRO)*; h) qualification of non-agreement with investors as a 'dead-lock' to be resolved by injunctions *(ASMI)*.[821] Remarkably, the very *ratio legis* of the very broad standard (for all 'legal persons') and its specific meaning *for issuers* was not tested and argued by the court. Thus, non-observance of these rules created by extensive interpretation of art. 2:8 NCC could be constituted by the court as violating the issuer's internal affairs regime. In the *ASMI*-case it even set aside an explicit, well-informed and extensively debated GMS-resolution to discharge the BoM and SB.[822] Equally remarkable is that the court disregarded the question of its own competence vis-à-vis the agencies for public oversight (AFM and the National Bank).[823]
'Restructuring and restoration of sound relations' does not therefore constitute a proper objective for judicial intervention in an issuer's internal affairs. It is clearly preposterous to require investors to assess their position by minutely studying the investigation procedure and the case law promulgated thereunder. Conversely, it seems at odds to require issuers in their prospectus and continuous disclosures to explain the (possible) impact of the Enterprise Chamber's (evolving) case law.

4.7 Judicial review of the Enterprise Chamber's case law on investigation rights of investors by the Netherlands Supreme Court

Although (still) confirming the original aims of the investigation procedure as discussed in this chapter, the Netherlands Supreme Court overruled a series of decrees of the Enterprise Chamber in investigation procedures initiated by (activist) investors against Dutch issuers. Its decisions in *DSM*[824], *KPN/Qwest*[825], ABNAMRO[826] and the *landmark decision* in *ASMI*[827] taken

819 Enterprise Chamber, 03-05-2007, LJN: BA4395, 451/2007.
820 Enterprise Chamber 24-03-2006, *JOR* 2006, 98 (Versatel).
821 Enterprise Chamber, 05-08-2009, *JOR*, 2009, 254; see also Enterprise Chamber, 1305-2009, JOR 2009, 163 and Enterprise CHamber 27-06-2008, JOR 2008, 230 and Enterprise Chamber, 20-05-2008, JOR 2008, 158.
822 See the *ASMI*-case.
823 See the *ASMI*-case.
824 Supreme Court 14-12-2007, LJN: BB3523.
825 Supreme Court 17-12-2010, LJN: BO3356.
826 Supreme Court 13-09-2007, LJN: BA 7970, BA 7971, BA 7972.
827 Supreme Court, 09-09-2010, LJN: BM 0976, BJ 4688.

together has now established quite clear guidance on such major issues as the entry to the procedure and intermediate 'stop orders', and, most importantly, reconfirmed the issuer's board supremacy and discretion. See especially *HBG*[828]*, ABNAMRO* and *Stork*[829], *ASMI.*
In the absence of a *stare decisis*-rule, however, this is not binding the Enterprise Chamber. Thus, a re-assessment of the basic statutory rules, taking stock of both the introduction of the protection of investors by the new securities regulation, the DCGC and the rulings of the Supreme Court seems to be due. This, however, is not yet reflected in the draft Bill to amend the investigation procedure.
Below I will summarise the most important rulings of the Supreme Court.

4.7 1 General explanation of the right of inquiry

In *KNP/Qwest,* the Supreme Court upheld the Enterprise Chamber's discretionary power to order an inquiry. However, it firmly ruled that, in using that power, the Enterprise Chamber should carefully weigh all interests, facts and circumstances of the case at hand. It also should take into consideration the disadvantages of a low entry for an investigation and the nature of the specific conflict. The Enterprise Chamber, hence, should argue its decision carefully. Summarising, this means that: a) the Enterprise Chamber and consequently the petitioners in drafting their request to argue (i) specific analysis and explanation of the previously discussed purposes, (ii) similarly the drawbacks against a broad application in the case at hand, (iii) the nature of the conflict and (b) for an explicit analyses of the interests of the corporation itself (enforcement of its internal organisational rules, reputation, but also its submission to securities disclosure – and other rules). Careful and conscientious application of these rules of the Supreme Court, already raise the thresholds for an inquiry as 'action'.

4.7.2 Higher standards for allowing immediate injunctive relief (DSM)

Immediate injunctive relief ('stop orders') can have profound and sometimes irreversible consequences for issuers. In the *DSM* –case, voting by the GMS on an amendment of the articles of incorporation, scheduled properly for the GMS-agenda, was blocked by an injunction. The Supreme Court overruled the order. It argued that the first step remains a judgement as to *whether there are well-founded reasons to doubt good policy,* but also confirmed that immediate injunctive relief may be granted before such decision has been taken. However, at this stage that power should be used only restrictively and taking into account and weighing properly all the interests involved. Hence, the injunctive relief should be proportional.[830] Once this is properly established, injunctive relief may be granted in any form (not limited to the list of art. 2:356 NCC[831]).

828 Supreme Court 21-02-2003, LJN: AF 1486.
829 Supreme Court 17-02-2007, LJN: AZ 6440.
830 Supreme Court 14-12-2007 (appeal in the interest of the law against Enterprise Chamber's decision of 28-03-2007, *JOR* 2007/118, with reference Brink), *NJ* 2008, 105 (with reference Maeijer); *JOR* 2008/11 (with reference A. Doorman).
831 See the conclusion of Advocate General Timmerman in the *DSM*-case, especially the sections 3.76-3.79 and 3.83-3.84.

The discussion in this and the preceding chapters seems to indicate that application of these procedural rules in cases against issuers should involve a judicial assessment of inter alia the ratio and effectiveness of alternative securities law protection of investors, the specific own interest of the issuer as a publicly traded firm, the competence of the AFM, the expected pros and cons of granting any injunctive relief and possible alternatives. This may substantially increase the standards to be applied.
The draft Bill to amend the investigation procedure does not elaborate on that further step and is limited to codifying the bare rules as described above.

4.7.3 Supreme Court reconfirms board supremacy and discretion (ASMI: a 'landmark decision')

These rules therefore still leave the Enterprise Chamber wide discretion, also with respect to the board's supremacy and discretion which had been severely eroded by a series of decisions, not least in the *ASMI*-case.[832] This decision was overruled by the Supreme Court – in my opinion a 'landmark decision'.
First, it reconfirmed the supremacy and discretion of an issuer's board. 'The board of a corporation should in executing its tasks as assigned by the statute and articles of incorporation place the interest of the corporation and the connected undertaking upfront and take the interests of all involved parties, under which those of the shareholders, into account in making its decisions. The strategy as followed by ASMI is therefore in principle a matter of the board and *the board, under oversight of the SB, will judge whether, and to what extent, it is desirable to have a consultation with its external shareholders.* The board of a corporation has indeed to account for its policy to the GMS, but it is, in the absence of statutory rules or rules of the articles of incorporation, *not obliged to involve the GMS upfront in its decision-making when actions within the authority of the board are concerned*.' It conforms its ruling in the *ABNAMRO*-case: there is no obligation for consultation or approval of the GMS for the sale of LaSalle, also not on the grounds of this extensively interpreted 'governance'-rules. In this *AMSI*-case a similar extension was overruled: the refusal to continue discussions with investors does not *per se* constitute a 'defensive and closed position'. The SB does not have a *mediating role;* such obligation would contravene *its discretionary freedom*. Furthermore, the Supreme Court overruled the qualification of a anti-takeover *foundation* as 'shadow director' *whose conduct should count in the assessment of whether an entry to the procedure should be allowed.*

Secondly, the Supreme Court accepted the complaint that the Enterprise Chamber insufficiently argued why the board's strategy and ASMI's internal organisation would meet the 'reasonable doubt' standard. Thus, the issuer's internal affairs and its charter have to be respected. Moreover, the Supreme Court overruled the findings of the Enterprise Chamber

832 See extensively M.J.G.C. Raaijmakers in his annotation under the Chamber of Business's decision, AA, 2009, p. 734-743 and G.N.H. Kemperink, 'De beschermingsstichting en de strategie van de vennootschap', in: Holtzer a.o., *Geschriftten vanwege de Vereniging Corporate Litigation 2009-2010,* Deventer: Kluwer 2010, p. 95-110.

as far as it is based unilaterally on the petitioners statements and, hence, *without explicitly taking into account the defence as presented by ASMI.*[833]

Thus, in my opinion the Supreme Court itself 'restored relations' in the internal affairs of issuers and restricted the admission to the investigation procedure, the effect of which is somewhat akin to that of the BJR. One could observe that thus a '*level playing field'* with the other examined jurisdictions had been restored and the investigation procedure is better embedded in the total regime for issuers of securities and corporate regulation and enforcement mechanisms (transparency, disclosure, auditor's control, internal monitoring, appointment/resignation, rescission of decisions).

Thirdly, as discussed above, the Enterprise Chamber often intruded into the internal affairs of issuers and effectively seemed not to hesitate to second guess entrepreneurial board decisions, as clearly illustrated in the *HBG*-case and the more recent *PCM*-case.[834] In the latter case with a final qualification of mismanagement and rescission of the GMS-decisions for discharge. It clearly illustrates its use as quasi-liability suit and its subsequent transit to a proper liability suit.

Note that the Code thereby (through '*duties of care & loyalty*') 'also gives content' to those requirements. However, it does make the principal starting point different, especially when actions of the board will also be judged also according to those requirements, were that to take place under the procedural safeguards of a (contra-dictionary) liability suit of an art. 2:9 NCC-procedure and also then honouring of the discretionary authority of the board, as is expressed by the BJR, is needed. That clarity is not (yet[835]) provided by the Supreme Court.

Nonetheless, I find that the reconfirmation of board supremacy, strengthening of the obligation to motivate and 'hearing' the corporation itself, not only strongly increases the threshold, but also substantive 'second guessing' by the Enterprise Chamber maybe does not exclude but in any case severely hinders it. The security of a statutory BJR is, however, lacking.

Fourthly, the Supreme Court had the opportunity to express its views on the meaning of 'protection'.[836] Before summarising its findings I recall two important elements in regulatory developments on this subject:[837] a) the new response time of 180 days now inserted in the DCGC (Best Practice IV.4.4) and b) proposed amendments of the 'Decree on Public Offers' (Besluit Openbare biedingen), including the introduction of a 'put up or shut up'-rule allowing the AFM to intervene when announcements or rumours on (possible) public bids

833 Cf. P.J. van der Korst and I. Wassenaar, 'Maak van de enqueteprocedure een dagvaardingsprorcedure', in: K.M. van Hassel and M.P. Nieuwe Weme (eds.), *Willem's wegen*, Deventer: Kluwer 2010.

834 Enterprise Chamber May 2010, *JOR* 2010/189 (with reference T.M. Stevens).

835 Is it wishful thinking if we remark that the *ASMI*-decision of the Supreme Court is only a small step removed from the *landmark decision* form the German BGH in the case *ARAG/Garmenbeck* and that has been codified by the German legislator in § 93 AktG?

836 See for an extensive overview of handled devices: Asser/Maijer/Van Solinge & Nieuwe Weme 2-II, *Rechtspersonenrecht: De Naamloze en Besloten Vennootschap,* Deventer: Kluwer 2009, CH. 10 (beschermingscontructies; certificering = protective devices and certificates)

837 M.J.G.C. Raaijmakers & Van der Schee, 'Regulering en handhaving van overnamebiedingen in perspectief', in: Marco Nieuwe Weme, Gerard van Solinge, R.P. ten Have (eds.), *Handboek Openbaar Bod*, Kluwer Juridisch, 2008.

confuse the market. Both changes have a direct impact on our subject, since they seem to clearly restrict the judicial power of the Enterprise Chamber in takeover and control fights. The standard as set in the *RNA*-case[838] (see chapter 3) is that protection in a (threatened) hostile takeover bid is allowed and conditioned only by the test of proportionality and temporality. In *Stork*[839], the Enterprise Chamber decided that the 'protective preference shares' as issued to the Foundation Continuation Stork (*Stork*) had to be withdrawn because, in short, the period of 'temporarily' had already ended by the time Stork negotiated with the requesting hedge funds. In the *ASMI*-case the Supreme Court overruled the qualification of the 'white knight foundation' as a shadow director whose conduct, hence, can be taken into account in assessing the issuer's conduct. Also the DCGC-response time was not taken into account by the Enterprise Chamber's decision but this was not discussed by the Supreme Court. The Supreme Court's decision thus completely overruled that of the Enterprise Chamber. It clarifies a number of questions. It confirms that the issuer's freedom of organisation includes the power to protect itself *ex ante* against a takeover of control or factual control. From a securities law point of view the issuer shall evidently fully disclose such devices.[840] Remarkably, the fact that ASMI had done so was virtually ignored by the Enterprise Chamber.

Apart from the new response time allowed to the target's board (Best Practise IV.4.4 DCGC), the Supreme Court seems to confirm that exercising the option right on protective preference shares does not in itself constitute any ground for starting an investigation procedure and therefore any blockade of the foundation's voting right, at least on the ground of the right of investigation, was eluded.[841] An 'attacker' and his legal advisers do know that and are forced to reach their purpose in negotiations. The picture in Delaware is not essentially different.[842] Except in '*Revlon*-situations', in which the corporation brings itself 'in play', the main rule of *Paramount v. Time* and *Paramount v. QVC* still stands: the board can 'just say no'.[843]

838 Supreme Court 18-04-2003, *NJ* 2003, 286 annotation Maeijer.
839 Supreme Court 17-02-2007, LJN: AZ 6440.
840 See also chapter 2 on the working of the capital market and the ECMH. The Enterprise Chamber ignored the defence of ASMI that such disclosure had taken place in the issuing and admission prospectus when extended its listing on NASDAQ (NY) to the exchange of Amsterdam.
841 Cf. G.N.H. Kemperink, 'De beschermingsstichting en de strategie van de vennootschap', in: Holtzer a.o., *Geschriftten vanwege de Vereniging Corporate Litigation 2009-2010,* Deventer: Kluwer 2010, p. 95-110.
842 M.J.G.C.. Raaijmakers & Van der Schee, 'Regulering en handhaving van overnamebiedingen in perspectief', in: Marco Nieuwe Weme, Gerard van Solinge, R.P. ten Have (eds.), *Handboek Openbaar Bod*, Kluwer Juridisch, 2008; cf. M.J. van Ginneken, 'The US Poison Pill from a Dutch Perspective', in: Dumoulin, Raaijmakers & Tervoort, *Tussen Themis en Mercurrius,* Deventer: Kluwer 2005, p. 121-142; B.F. Assink, *Rechterlijke toetsing van bestuurlijk gedrag,* Deventer: Kluwer 2007. Cf. Stephen M. Bainbridge, 'Unocal at 20: Director Primacy in corporate takeovers', *University of California, Los Angeles School of Law, Law & Economics Research Paper Series NO. 05-19*, September 2005, p.3; Christian Kirchner and Richard W. Painter, 'Towards a European Modified Business Judgment Rule for Takeover Law', *European Business Organizations Law Review* 2000, p.13.
843 Cf. also Nieuwe Weme in his annotation under Enterprise Chamber 13-04-2007 (ABNAMRO),

4.8 Back to the draft Bill to amend the Dutch investigation procedure

Thus, the Supreme Court in ASMI effectively strongly conditioned the application of the investigation procedure against issuers. This coincides with the corrective amendments in the NCGC, primarily the response time for target boards in case of a hostile takeover attempt, and the new takeover rules, especially the 'put up or shut up'-rule. One could question whether issuers should not be completely exempted from the investigation procedure in view of the investor protection in the new securities regulation, governance code and extension of shareholder's rights. This question, valid as it may be, is not (yet) on the agenda. The Supreme Court's decision, however, seems to be better aligned to the borderline between corporate and securities law and thus also to reflect the comments of the Social and Economic Council and of academia to introduce some form of the BJR into the investigation procedure.

Assink and Kroeze proposed inserting the BJR into the structure of the investigation procedure, based upon their important and interesting research into the relation of the BJR, derivative suits and the investigation procedure. I strongly support their pleas, although this study clearly reveals the highly exceptional position of Dutch issuers being exposed to the investigation procedure alongside the ('European') investor protection as provided by the new securities regulation. Assink and Kroeze focus on judicial review as the initial test for entry into the investigation procedure and the final judgement of 'mismanagement' thus increasing the thresholds for (marginal) judicial review. They do not suggest inserting the BJR, as in the US and Germany, into the central provision on tasks and assignments of directors (of legal persons) and their powers and the liability as provided for in art. 2:9 NCC. Also the Social Economic Council did not propose such a direct connection, but rather defended settling board independence and discretion ('freises Ermessen') by applying the fundamental idea of the BJR to the admission of the right of inquiry ('well-founded reasons to doubt good policy'), the final judgement as to whether there are grounds for 'mismanagement'[844], but obviously also in the judicial decisions on granting immediate injunctive relief. The last element remains underexposed in the debate.

The explanatory notes to the draft Bill published by the Ministry of Justice reject the idea of transferring the (notion of) BJR to the method of and standards for judicial review in and/or the admission to the right of inquiry: 'In practice it is of importance that the court sufficiently argues why it finds that there are well-founded reasons to doubt good policy or mismanagement has taken place. The far-reaching consequences of an inquiry procedure and/or the ordering of immediate injunctive relief for the legal person and interested parties, justify that these decisions shall be well argued and motivated. There is no reason to replace "well-founded reasons to doubt good policy on the part of the company" and "mismanagement" with another description. Granting injunctive relief by the Enterprise Chamber is only justified if there are serious indications that the policy of and operations of the legal person *are not have (been) just and/or that serious mistakes have been verified* (Italic: *PvS*).' That last element again implicates, if I am correct, a judicial review and not the indemnification that

844 *Advies Evenwichtig Ondernemingsbestuur 08/01, p. 53.*

the BJR offers as presumption of good governance. Neither does this limit the power of the Enterprise Chamber to develop new rules.
That reasoning disconnects the BJR from art. 2:9 NCC, where it actually belongs. Remarkably the explanatory notes to the draft Bill make a 'cross-over' from the *derivative suit* (Delaware) to the Dutch right of investigation and conclude that the BJR does not fit in that procedure and leave it that way. "The Social Economic Council did not argue to copy one-on-one the criteria for reviewing board decisions that have been developed in Delaware into Dutch law. That is also not feasible, because fundamentally a system of precedent law is prevailing and not a codified system (apart from the fact that the manner in which justice is administered and of judicial construction resembles more the system of precedent of a common law system)." Apart from overlooking the fact that case law of the Enterprise Chamber also creates precedents albeit without the certainty of the *stare decisis* rule, the reasoning of the explanatory notes seems to fail, since the BJR can very easily, as in Germany, be introduced in art. 2:9 NCC. That would be the proper way since Delaware indeed has no investigation procedure or a comparable action for 'injunctive relief'. On this subject the explanatory notes seem to make the wrong connection by saying that a BJR is not feasible for that action since they focus on *order measures* ('ordemaatregelen') as required by the 'condition of the legal person and in the interest of the research'. However, application of the BJR is enframed in the question of whether and if so how a business decision could or should be reviewed by the court which is not related to an 'order' but to a judicial assessment of (the merits of) a regular business judgement and business policies. The scope of judicial review therefore differs. The explanatory notes seem to miss the 'hands off'-rule of the BJR respecting the board's entrepreneurial and discretionary freedom.
In my view, the explanatory notes miss here the crucial element of judicial grants of injunctive relief that are so problematic in case of *issuers.* With the experiences of the last decade's case law applied in cases against issuers, the question arises as to whether preference should be given to regular summary proceedings on liability where plaintiffs have to state accurately the facts and the norm that were allegedly breached and which allow for a proper defence. This would prevent the Enterprise Chamber, without even judging whether there are 'well-founded reasons to doubt good policy on the part of the corporation', from placing itself in the position of an umpire for the duration of the whole procedure. The explanatory notes do not address this.

4.9 The investigation procedure for issuers and HLG-recommendation (2002) to be reconsidered

The investigation procedure is unique. Its application to issuers is problematic since it is not carefully linked with the new securities regulation nor properly assessed; at least harmonisation with the applicable regime for listed corporations as applied elsewhere is important considering the strongly increased foreign investments in Dutch listed corporations, the mobility of investors, but just as much for the attractiveness of the Dutch business climate for listed public corporations. The right of inquiry seems, when compared to the other systems, at odds with regulation of a listed public corporation.

If we only look to the Netherlands, then the previous analysis illustrates, in my view, that purposes of the right of inquiry cannot bear application to listed public corporations. The described practical experiences do not lead to any other insight. The *ASMI*-decision of the Netherlands Supreme Court takes away a lot of uncertainty, however it does not provide certainty in answering the many questions that will rise when applying the right of inquiry as still governed by its open purposes, especially in taking immediate measures and in using the right of inquiry as a quasi-liability procedure. Therefore, it does not seem illogical to exclude the right of inquiry for listed public corporations.
The international familiar regime for private law devices for listed public corporations is mainly underpinned by securities fraud – and liability actions. Again it does not seem illogical to adjust the Dutch system for listed public corporations. If one should choose to eliminate the right of inquiry for listed public corporations, then it seems to be logical to introduce it as a derivative action, as previously argued by Kroeze in his dissertation[845], and also in that respect to connect with the international regular regime for listed public corporations. German law provides a continental example of this.
Considering the analysis of chapter 4 the conclusion seems to be that introducing, according to the HLG's proposal of 2002, an investigation procedure at EU level does seem justified. This investigation by its nature is at odds with the securities disclosure system and with corporate law for (listed) public corporations. The analysis of chapter 4 also leads to the conclusion that the Dutch right of inquiry should be re-examined. This does not mean that the idea of a BJR, without a right of inquiry, is not of interest for preserving board supremacy and discretion. Also the US and German systems offer a certain solution. Delaware goes even further and displays totally different fundamental position by safeguarding the supremacy and discretion of the board also by statutory D&O/indemnification.

845 M.J. Kroeze, Afgeleide schade en afgeleide acte (diss. Utrecht), Deventer: Kluwer 2004.

5

Closing and synthesizing observations: Issuers as addressee of (self) regulation, public oversight, judicial review and private enforcement in between securities and corporate law

The preceding chapters may have illustrated the influence of the generalising L&E debate on the paradigm change from 'apathic' to 'activist' investors in globalising financial markets and investors and on the governance of issuers in which they are investing. That debate included an in-depth analysis of differences in markets, shareholders base (full dispersion versus different types of block holdings), changes in the demography of investors (rise of institutional investors, pension funds, state wealth funds, hedge funds, private equity) and the impact on the dynamics of market regulation and investor protection in the relevant jurisdictions. The 'agency theory', its analysis of 'moral hazards' and, hence, the need for disciplinary mechanisms (disclosure, bonding, alignment, market for corporate control) implicitly claims a sort of theoretical 'universal truth' that would cause or result in a substantial convergence of the regulatory environment for issuers. Indeed these theories (backed up with and further elaborated by immense subsequent worldwide research) and the push of (global) investors for their practical implementation had a remarkable influence both on corporate practice (aligning incentive programme, investor relations, governance, successful pressure on abolition of protective devices) as on regulators (such as the fall out from the 2002 HLG Report). However, markets remain different and does the equity base of issuers (ranging from wide dispersion to block holders and limited free float) and what is *equally important*: the regulatory framework and societal environment. The preceding comparative analysis of resulting regulation seems to confirm the differing 'path dependent' jurisdictional realities in which issuers have to operate. These reveal quite different mixtures of regulatory options and choices responding to these developments and the growing influence of investors: a) the extension of substantive shareholders' corporate law powers, b) the facilitation (and sometimes – such as in the case of empty voting and securities lending – further regulation) of the *use* of these powers (proxy solicitation, identification, technical rules such as the introduction of record dates), c) the introduction or strengthening of public oversight and sanctions, d) intensifying oversight in the issuer's internal organisation (strengthening the powers of – independent – non-executive directors, e) strengthening of 'oversight' (review) and accountability of independent public auditors, and last but certainly not least f) extension and enhancing of the issuer's disclosure requirements.

Comparing the US and EU, the regulatory choices that were made appear to differ substantially. The former is still characterised by the combination of on the one hand a well-established, standalone and federal market-oriented securities regulation focussing on investor protection and supported by strong federal public oversight and on the other hand a competitive state corporate law that, as in Delaware, firmly establishes the business-oriented organisational principles of corporate law, primarily board supremacy and discretion.

The EU, on the other hand, introduced a US-style 'federal' securities regulation with national (not yet federal) public oversight, but continues to build – also in its securities law disclosure – on its corporate law protection of shareholders in public corporations both at the level of Member States and of the EU itself. The clear demarcation of both branches of regulation that is characteristic for the US is, as evidenced in the comparative inventory in the Annexes, not present in the EU.

The corporate governance – and much of the L&E debate – focuses on the division of powers between corporate actors: board (NED/SB) and shareholder meeting/groups of shareholders. The use of seemingly similar concepts and parameters seems to conceal the remaining strict demarcation between federal securities and state (Delaware) corporate law in the US and the more diffuse situation in the EU (and Member States). It explains the different regulatory responses over the last decade in the US and the EU. The response of US Congress to "Enronitis" in the SOx and subsequent SEC-regulations and NYSE and NASDAQ listing rules, was almost completely restricted to enhancing the prevailing securities regulation of the 1933 and 1934 Acts, focussing on investor protection by means of strict disclosure requirements for issuers and by public oversight (SEC) and private enforcement (especially securities fraud action). Their function remains investor protection and market transparency, not – as in the EU – (also) to protect the interests of creditors and other stakeholders of issuers. It did not, apart from audit committees, substantially change the internal affairs and governance of corporate issuers, board supremacy and discretion. Unlike corporate law of EU jurisdictions on 'public' corporations, 'US' corporate law does not aim specifically at investor protection, although investors may apply corporate law procedures (such as derivative suit, proxy voting) to discipline and challenge an issuer's board on the basis of breach of fiduciary duties, for example.[846] US shareholders' rights are restricted to annual board elections and approval of major transactions. The board will be protected by indemnification rules in issuers' articles of incorporation, by directors and officers (D&O) insurance, the business judgment rule (including the 'just say no-rule in contested takeovers). This US model of corporate state law survived the recent 'fire alarms'. Although in the US the recently enacted rule concerning shareholder's nominees for the board gives shareholders some influence on the composition of the board, this new rule does not allow shareholders to gain control over the board; they may only nominate a restricted number of directors and only if not in order to gain control.

This paragraph will summarise some major differences between the EU and US regime for issuers.

Thus markets will continue to develop as will strategies and policies of (major) investors and regulators at all levels. There seems no end to corporate history (Hansmann &Kraakman) as illustrated by divergent political, societal forces and regulatory responses to the two recent major fire alarms: Enronitis (2003) and the financial crisis (2007). Law continues to matter (SLLV) in its full 'path dependent' and broad societal meaning, i.e. including regulatory political and societal framework, its civil and commercial legal traditions, the framework for oversight and enforcement, the role of the judiciary and the means and framework for broad and narrow private enforcement by investors themselves. In the EU, the May 2003 Report of the EC still seems to guide its agenda, albeit that the 2010 Report on the Transparency Directive tends to concentrate more on developing the EU disclosure system alongside the more corporate law-oriented May 2003 Report.

All these observations guided this study and led to my central hypothesis that a clear dichotomy between aims, nature and scope of securities and corporate law is needed to enable proper analysis and guidance both at EU and Member State, as well as at international level, implementing, absorbing and enforcing of (new) rules for investor protection and thereby contributing to a consistent regulatory system needed in its further development and reaction to new circumstances: globalisation of markets, entrance of new players such as state

846 Cf William W. Bratton and Michael L. Wachter, 'The Case against Shareholder Empowerment', *University of Pennsylvania Law Review*, vol. 158: 653, 2010.

wealth funds and hedge funds, extension of international financial reporting standards, new financial instruments and techniques such as stock lending and empty voting, mergers of stock exchanges, creation of new market platforms (MIFID), other techniques to acquire control of issuers alongside a takeover or proxy fight, development in suits that support shareholder and again, last but not least, the organisation and governance model of issuers.

The broadness and complexity of the subject induced a limitation of its scope. I refrained from a repetitional review of the L&E debate. Although its subject is really 'global', I also refrained from a global analysis and limited myself to a 'transatlantic' comparative summary inventory of prevailing securities and relevant corporate law and aimed to elucidate the basic architecture as well as its major changes (and direction) of and regulatory responses to Enronitis and the financial crisis. Evidently, a multitude of subjects will require further study.

5.1 Disclosure and accounting; Descriptive analysis and comparison of the US and EU regulation (of) issuers and markets, disclosure versus accounting

The Introduction explored the dual regulatory perspective and dichotomy between securities and corporate law to protect the investors in financial instruments, particularly shares, by proper disclosure rules and shareholders' rights and powers respectively. Chapter 2 explored and compared in more detail the first layer of investor protection as provided for by US and EU securities law and its relation to corporate law, focussing on the standalone (or mixed) character of initial and continuous disclosure and any impact on the governance of issuers upon going and while being public. That chapter therefore explored from the perspective of the US and EU financial market regulation and securities law (mainly related to disclosure and accounting regulation of the issuer) the requirements for issuers and the question of whether and to what extent (the regulatory aims of) such regulation affect the internal affairs and governance of issuers upon going and being public. My hypothesis is that the comparison between the US and (Member States of) the EU will reveal the standalone character of federal US securities regulation and a somewhat mixed character of EU regulation that remains linked to some extent to corporate law and thereby in the EU and examined MS, especially in the Netherlands, caused overlap and frictions of the securities disclosure systems as implemented in the MS with the existing national system of corporate law.

5.2 EU-US: convergent securities law

In the EU, the execution of the FSAP (1999) resulted in a 'federal' and US-style separate layer of European securities regulation focussing on market regulation and investor protection through initial and continuous disclosure requirements and statutory enforcement through public oversight and private enforcement by means of a series of EU directives and regulations on prospectuses (IPO), admission to listing/trading, continuous disclosure and transparency, market abuse and the application of IFRS in the issuer's (consolidated) annual financial report. As in the US, disclosure serves its disciplining monitoring function. Member States implemented these new rules to replace the existing self-regulation by stock exchanges and the securities industry, but often additionally overlapping with existing *corporate* law protection of investors, including rules on 'internal accounting' to shareholders (AGM). The resulting differences in substantive law and enforcement, do not take away from the fact that its design resulted in integrated 'federal' EU securities law, although without federal public oversight but with coordination by CESR (by now ESMA). Aiming at a common financial market, the EU regulations provide for mutual recognition of prospectuses and other disclosure documents. The core of the new EU continuous disclosure rules is the issuer's annual financial report consisting of its annual accounts, management report and a certification by its responsible persons that these provide a true and fair view. To allow comparability and standardisation of disclosure documents the issuer's *consolidated* accounts shall be drafted in accordance with IFRS. Like the US Report to Shareholders (10K-20F), this annual financial report effectively serves as a standalone market and investor-oriented disclosure document. Thus going public results, for both US and EU issuers, in materially similar securities regulation (including listing rules) becoming and remaining applicable.

5.3 EU disclosure (Annual Financial Report) connected with (1st,4th,7th and 11th) company law directives

However, EU securities law rules and the annual financial report also build on and remain connected with the parallel *corporate* law accounting and disclosure rules of the 1st, 4th and 7th *company* law Directives that apply to *all* (close *and* publicly held) *companies.* These provide mandatory stakeholder-oriented rules for single and consolidated accounts with their own accounting, audit and 'classical disclosure' rules, i.e. through filing with the commercial register (or similar agency).

I observe that not all Member States have (yet) embodied the sharp distinction between the securities law objectives as reflected in the concept of the 'annual financial report' for issuers of the Transparency Directive and the remaining corporate law procedures and concepts of the 4th and 7th Directive as reflected in their national (corporate) law. The conceptual overlap and linkage between securities law disclosure and corporate law 'accounting' is illustrated both in the structure of the accounts as well as in the corporate action for finalising, adoption (and subsequent disclosure to the market).

5.3.1 The Transparency Directive requires disclosure of the annual financial report, i.e. the financial statements, the management report and the declaration of responsibility, i.e the certification by the persons responsible for its content. The issuer (as corporate entity) *itself* shall make annual accounts in accordance with the 4th Directive, which applies to *all* commercial corporations irrespective of they are being 'public' or privately held. If, as required for issuers, it has to draw up *consolidated* accounts, the IAS Regulation requires that IFRS shall be applied. The management report remains clearly separated – also in the audit and approval – from the financial statements and follows art. 46 of the 4th Directive; since IFRS itself does not (yet) contain standards for the management report. This system differs from the US annual report to shareholders (on Form 10-K for domestic and Form 20-F for foreign issuers) in various ways. It only applies to *issuers*. It follows separate and focussed securities regulation, particularly the SEC's Regulation S-K and is therefore not in any way linked to or constrained by any broader application to non-issuers. The management report is integrated in the disclosure document (Item 303 Regulation S-K) and therefore not separated as in the EU. The report upon its finalisation (after the audit committee's approval) will be signed (and certified) by the CEO and CFO (§§ 303 and 906 SOx) and filed promptly with the SEC and be thus disclosed.

The preparatory process of drawing up and internal discussion with the audit committee and external auditor is similar, but disclosure on the procedures followed takes a different form (certification versus 'declaration on responsibility' and narrative discussion in MR of risk factors and management; in the EU the last mentioned often is dealt with in national corporate governance codes). Final corporate action on adoption and disclosure differs as well. Whereas the UK rules are akin to those in the US, Dutch law still requires (in German law as an option) submission of the report (with audit opinion) to the AGM *for adoption* of the (audited) accounts (*only*) and subsequent filing with the AFM (that only then can act to 'correct' the financials if these, in its opinion, are misleading) and – like all other non-issuers – with the commercial register, although securities law disclosure to the market should take place promptly upon finalisation and signing by all members of the board of management and the supervisory board. Filing the annual accounts with the commercial register also required an updated audit report which seemingly leads to extra costs (however further empirical research is needed). Thus the corporate procedures and actions to submit annual accounts for adoption to the AGM (as in the Netherlands, but not in the UK) is at odds with the standalone securities law disclosure character of the annual financial report (art. 4 Transparency Directive). The connection with corporate law procedure of adoption and finalisation of the financial annual report/accounts and enforcement and means for restatements shows the tension enforcing market-oriented substantive rules. The request for a restatement has to be filed in the Netherlands within two months *after* the adoption of the annual accounts. By then the issuer has to assess whether this requires disclosure by the Transparency, Market Abuse and Stock Admission Directives. Although adoption of the annual accounts/report includes implicit or explicit discharge of the directors, the question remains as to whether and if so how *ex post* liability of the issuer and its directors and officers for misleading annual and intermediate reports are addressed.

Historically, discharge of the board was closely connected to adoption of the annual accounts by the AGM as finalising the 'accounting' of management to shareholders. This element is unknown in the US and covered by indemnification provisions, D&O insurance and in court (derivative suit) by the business judgement rule.

5.3.2 Thus the new US-style EU securities disclosure system in various Member States remains connected to internal corporate law accounting concepts, i.e. the board 'accounting' to its GMS as a body corporate within the issuer's internal organisation. The 4th and 7th Directives (note: applicable to *all* 'companies') were amended (2006) to insert new items to be discussed in the MR, related party transactions, but also on collective board responsibility for the financial report and – *for issuers only* – the requirement to report on compliance with the issuer's national corporate governance code as well as disclosure of a separate corporate governance statement (cf art.10 Transparancy Directive).[847] These in turn contain a series of disclosure items (board composition, directors, meetings, etc). Such disclosure was thus used as regulatory tool allowing investors and the market to monitor the compliance with corporate governance codes. Thus the management report allows for 'sideway influx' of corporate governance rules and, as analysed in chapter 4, to a sort of enforceability (such as in the Dutch inquiry procedures) albeit without BJR-protection. The UK CGC is connected to the LSE listing rules, allowing the LSE to take sanctions upon non-compliance, without intruding into the internal organisation. Note that these codes aim both at enhancing disclosure to investors and at strengthening the position of shareholders *in meeting.* They thus *do not* reveal a similar dichotomy.

5.4 Public enforcement in securities law (securities fraud action)

Public enforcement is exercised by national public agencies (including restatement procedures). Private enforcement of the issuer's initial, continuous or intermediate disclosure duties by dissemination of 'misleading' information to the investors and the markets is vested in the securities fraud action against the issuer as such to restore to them (as a 'class') their damages. Unlike the US (§ 10b SEA'34 and Rule 10-b) the EU did not provide for a federal securities fraud action, but assigned the Member States to provide for proper civil actions. In comparison to the US, class actions are less developed, but for example the Netherlands now allows a 'collective' actions (art. 3:305a NCC)[848] and a settlement to be declared binding for a whole 'class' (arts. 7:907 and further).[849]

5.4.1 Being left to the Member States, public and private enforcement of these combined and entangled new rules reveal remarkable differences. The way that the role and responsibility of authorities to require 'correction' of defective annual financial reports have been implemented shows remarkable differences, as does further comparison with the SEC's powers. Evidently, disputes on the correctness of disclosure documents may also affect the assessment of the statutory audit that was exercised. An important difference with the US remains that the EU, although aiming at integration of the European financial markets, has not yet created a European SEC, although CESR has been assigned with a coordinating role that as from 24 November 2010 has been attributed to ESMA. Since public oversight extends to compliance by issuers with IFRS, the dispersion of oversight between national authorities

847 Directive 2006/46/EC of the European Parliament and of the Council of 14 June 2006 amending Council Directives 78/660/EEC on the annual accounts of certain types of companies, 83/349/EEC on consolidated accounts, 86/635/EEC on the annual accounts and consolidated accounts of banks and other financial institutions and 91/674/EEC on the annual accounts and consolidated accounts of insurance undertakings, *OJ L 224, 16/08/2006, art. 46a Dir 4 and arts.* 50b/50c Dir4 and arts. 36a/36b Dir7.

848 See HR 27 November 2009, *LJN* BH2162 (*WorldOnline*) and Hof Amsterdam 25 January 2007, *LJN* AZ7033 (*Dexia*)

849 See Court of Appeals Amsterdam 29 mei 2009, *LJN* BI5744 (*Shell*), see also B.J. de Jong, p. 315 e.v.

does not guarantee uniform interpretation and application thereof even though the ECJ has final jurisdiction in these matters.
Private enforcement of the new EU securities regulation, also of disclosure of the annual financial report as the key disclosure document, is left to the Member States to fit into their national legal systems and traditions. My analysis reveals that the classic accounting approach already seeks to attribute shareholders (AGM and individually or groups) with powers in the corporate decision-making process with respect to laying down, discussion and even adoption or approval. The flipside thereof results in the principle that those that did account duly and properly will be discharged from the execution of their tasks and assignment during the reporting period. This approach, as observed, still characterises (corporate) law in some EU jurisdictions. Specific actions for damages caused by misleading information are embedded in principles of tort law. Specific prospectus liability for promoters was addressed at an early stage, but enforcement of continuous disclosure rules is evolving.

It is expected that the focus will shift towards assessment of the correctness of the annual financial report within the decreasing limits of managerial discretion in the application of IFRS.

5.5 Investor protection in corporate law: shareholders rights and board supremacy in the 'internal affairs' of issuers

In the Introduction, I briefly referred to the famous article by Hansman and Kraakman on the end of corporate history. They claimed the dominance of the corporate ideology of shareholder primacy leading to major jurisdictions adopting similar rules of corporate law and practice. Their claim in a certain way illustrates a school of thought in corporate governance observing and forecasting convergence of corporate governance systems all adopting shareholder primacy as the best model to generate most value for the corporation and its shareholders, keeping directors' interests aligned to shareholders. Their approach essentially follows the analysis of the 'agency theory' as developed in the Law & Economics literature: shareholders are 'principals', 'residual/ultimate claimants' and 'owners' of the corporation, the corporation's board (members) and officers being aligned to the shareholders' interests. Shareholder orientation and the hegemony of the shareholder model would eventually replace 'employee' and 'state orientation'. Then the dotcom bubble burst and corporate scandals erupted. Remarkably the regulatory responses on both sides of the ocean differed substantially putting the former claim in a different perspective.[850] US securities law was amended to enhance financial disclosure by the SOx, but the prevailing principle of board supremacy and division of powers in the internal affairs of US issuers

850 John C. Coffee Sr., 'A Theory of Corporate Scandals: Why the US and Europe Differ', in: John Armour and Joseph McCahery (eds.), *After Enron, Improving Corporate Law and Modernising Securities Regulation in Europe and the US*, Oxford: Hart Publications 2006.

remained, at least conceptually, unchanged. In contrast, the EU did not limit itself – as did SOx in the US – to building on the basics of the then emerging EU securities law as discussed in chapter 2, although it accelerated the regulatory FSAP-process. Both at the level of the EU and of its Member States, discussions and, hence, regulation focussed on enhancing corporate governance by means of corporate governance codes, amendments of corporate law and new case law resulting in a shift of powers in the internal affairs of issuers by rules on oversight by non-executive directors, powers of the AGM and of individual shareholders, the role of independent auditors, the relationship and 'dialogue' between issuers and their investors, executive compensation and the mechanics of the market for corporate control.

The introduction of the EU securities law neither stopped nor channelled the debate. The increasing shareholder activism illustrated again that law matters. The developments also showed that relevant law did not converge, but rather took different routes on both sides of the Atlantic. If we look from the perspective of issuers, the question can be raised as to whether and to what extent their internal affairs do indeed converge, especially if we focus on the supremacy and discretion of the board. My hypothesis is that convergence of securities regulation seems to go along with a certain degree of divergence of the corporate law regime for issuers in the examined systems as related to the division of powers between the board (BoM/SB) and the GMS and (groups of) individual shareholders. GMS rights are of course important, such as GMS required approval for an important change of identity or character of the corporation entailing a low threshold such as in the Netherlands of one third subsequently influences the supremacy of the board (BoM/SB). However, alongside the collective powers of shareholders 'in meeting', the GMS as a body corporate of the issuer, shareholders also have statutory individual and groups rights and powers. Individual rights evidently encompass voting rights, the right to receive dividends and distributions from a pay out by the issuer and the residual rights upon dissolution. As part of these individual rights of shareholders, the possibilities to make them concrete by using the mechanism of voting, such as the possibility to call an extraordinary meeting, to put items on the agenda of the meeting, possibilities of proxy solicitation and voting influences the division of power between the board and the shareholders. The level of influence of the shareholders in the company (board supremacy) is, apart from the substantive rights of the shareholders, partly determined by these procedural rules related to convocation of a meeting and setting the agenda for the meeting. For example, whether and under which criteria the board/BoM under its discretion has the right to refuse to put an item on the agenda as it proposed by the shareholders seemingly influences a company's vulnerability to shareholder activism.

In particular, if focussing on the supremacy of the board, the Dutch system in comparison to the other examined systems' GMS substantial rights and procedural shareholder's rights to effectuate these rights seemingly led to a stronger position in the organisational design of the issuer than in the other examined systems (in combination with the unique Dutch right of inquiry, as has been elaborated in chapter 4 this seemingly resulted in an erosion of the Dutch board supremacy). This seems, however, to be concealed by the international hype of corporate governance and resulting principles and 'best practices' to discipline management and protect investors. They also conceal the lack of clear US-style distinction between the regulatory ends and means of securities regulation and corporate law. It seems to bypass the traditional regulatory role of corporate law in (Member States of) the EU to protect investors (shareholders) *by means of corporate law* (often based on 'institutional' and the so-called 'stakeholder' model). Thus Chapter 3 explored in more detail the (statutory) division of (collective and individual) powers of investors (GMS) and the board/SB and, hence, both the nature of protection thus provided to investors (as shareholders) and the statutory level and extent of board supremacy, taking into account recent developments that affected the prevailing systems. Although there is more than one good reason to extend the research to other areas as well, this was limited to these two markets.

5.5.1 EU: investor protection through corporate law: (extension) of shareholders' rights

So a clear demarcation between securities and corporate law protection does not prevail in the EU as was again illustrated by recent regulatory responses to the challenges of 'Enronitis' and the financial crisis. This is not new. From the early days, EU law tended to elaborate corporate law and governance to protect the interests of investors (shareholders). The 1972-draft 5th Directive, until its withdrawal in 2004, aimed at harmonising the basics of corporate governance by mandatory 'internal' governance rules: the division of powers between management, supervisors (NEDs) and the GMS. Its model was the German AktG (1965) designed as '*Publikumsgesellschaft*' and therefore providing investor protection by means of corporate law. Compare the famous US debate on the 'race to the bottom' initiated by Professor Winter in 1964.

The 2004-withdrawal of the draft 5th Directive followed in the hectic days of Enronitis, the 2002 HLG report, the strategy developed in the May 2003-reaction of the EC, the fierce debate on the Takeover directive (market for corporate control), coincided with the finalisation of the EU securities law in the execution of the FSAP (1999) and US SOx, but also with the emergence of a growing series of national corporate governance codes (starting with the UK Cadbury Code of 1992 that responded to the BCCI- and Maxwell-scandals but gradually changed towards (investor driven) codes, see chapter 3.2 for an overview of the historical development of these codes). Neither the emerging EU securities law, nor the withdrawal of the draft 5th Directive changed the regulatory perspective looking towards a strict demarcation of both branches of regulation. The links remained also with corporate law. The subsidiary principle (art. 5 EC Treaty) did not completely discourage the initial aim to harmonise all major company law issues for on 'public' companies (as a corporate form for businesses rather than issuers). May 2003: *acquis communautaire*!

Thus also after 2000/2001 corporate scandals, in comparison to the US SOx, the changes in the EU were different. Their responses were fragmented over corporate and securities law rules by different regulatory instruments, amending prevailing EU *corporate law* directives and issuing new recommendations and – at the national level of Member States – by amending corporate law (see the Netherlands' strengthening of shareholder rights), but also introducing 'self-regulatory' codes of best practice, part of which focussed on the role and organisation of boards, the role of executive and non-executive directors, the role of the GMS and, hence, the division of corporate power between these bodies corporate.

5.5.2 Takeover Directive: securities and corporate law

Whereas, in the US, Williams (1968) was restricted to adding 'traffic rules' for takeover bids in the SEA'34 without intruding on corporate law and the use of anti-takeover devices (including the 'just say no'-rule), the very fierce EU debate on the 13th Directive concentrated effectively on mandatory board neutrality in the case of a hostile takeover bid to create a level playing field in the EU market for corporate control (by mandatory neutrality and break-through rules). It introduced the mandatory bid upon acquisition of effective control and public oversight of the bidding process but, remarkably, refrained from focussing on common EU 'traffic rules' to be applied by the offeror and target-issuer in the framework of the then forthcoming EU securities law. It resulted in 'traffic rules' on proper market disclosure to allow a proper assessment and judgement being made by the market and the investors, but at the other hand in *optional* corporate law rules on the 'internal' relationship between the board and the investors and the meeting of shareholders.

5.5.3 EU: corporate governance codes (soft law in between securities and corporate law)

That lack of distinction may also have contributed to the emergence of corporate governance codes in the EU as 'self-regulatory' responses to both the growing pressure of investors and the financial markets for extension of investor protection (including 'market for corporate control') as well as – later – to Enronitis. The first tendency explains 'shareholder friendly' amendments to corporate law before and during the execution of the FSAP (1999), the second could continue to build on this regulatory 'innovation'.

As discussed above, the EU reacted by recommendations on NEDs and executive pay, amendment of corporate law Directives (4th, 7th and 8th) and adopting the Takeover Directive and Shareholders' Rights Directive. Member States amended their corporate law and 'supported' 'self-regulatory' corporate governance codes and obliged issuers to report ('comply or explain'). The new US-style EU securities disclosure system and the disciplining monitoring function thereof was apparently not absorbed. Regulators apparently did not distinguish between investor protection through securities regulation, based on that new pillar, and corporate law and corporate governance codes. It caused remarkable overlaps as was illustrated above with the annual accounts as disclosure document and as 'accounting' to the GMS and the function and format of the management report (extended with mandatory reporting on compliance with governance codes) and combined with different enforcement mechanisms (public oversight, discharge in absence of the BJR, restatements and annulment, but also immediate measures in Dutch inquiry procedures) seemingly to enforceability of these codes (as has been elaborated in chapter 4).

These codes are a mix of securities (disclosure) and corporate law (intrusion in different ways and degrees into the internal affairs of issuers). The rules deviate as well as – apart from the comply or explain-rule – the enforcement (and oversight) mechanisms.[851] In the Netherlands, observance of the Corporate Governance Code is primarily a matter for discussion in the GMS, but non-observance may be subject of judicial review in an inquiry procedure before the Enterprise Chamber Amsterdam Court of Appeal (at least if and as far as the issuer 'committed' itself to observance).[852] Being linked to LSE Listing Rules, non-

851 Cf. Wymeersch.
852 See e.g. Enterprise Chamber 5 August 2009, *LJN*: BJ4688 (*ASMI).*

observance of the UK Code may, at least theoretically, cause delisting.[853] These differences also influence exposure to shareholder activism, as has been elaborated in chapter 4.[854]

5.5.4 Intrusion into internal affairs of issuers

Therefore, in hindsight Hansmann and Kraakman seem to have been right in their 2003-analysis that *at that time* EU public corporations (issuers) were also moving towards (increasing) shareholder orientation, but they apparently did not foresee that the simultaneous introduction in the EU of a US-style securities law and extension of the powers of shareholders and their enforcement could result in a considerable intrusion into the internal affairs of issuers to the extent of eroding the principle of board supremacy in managing the issuer's affairs. In the following years, such erosion seemed to emerge particularly in the Netherlands where (activist) investors successfully challenged in some major law suits large issuers' board supremacy and discretion in the pursuit of the issuers' strategy and policies. This can be explained by some coinciding factors: growing pressure of financial markets and investors especially in the direction of enhancing the market for corporate control, early reactions of the legislator to renew the rules for takeover bids and extension of shareholders rights, the introduction of a bill – in advance of a definitive 13th EU Directive – to limit anti-takeover defences, the introduction of a (first) set of recommendations on corporate governance and followed (after the outbreak of 'Enronitis') by a full Netherlands Code on Corporate Governance, together with the then emerging renewal of securities law and introduction of public oversight. In these circumstances, the very broad powers of the Netherlands Enterprise Chamber in an inquiry procedure (including assessment of '(mis)management') were applied to the principle of board supremacy and discretion. And although the Netherlands Supreme Court in several cases (most recently *ASMI*) overruled such judgements, the practical impact on issuers confronted with requests for changes of strategy and policies (including but not limited to break up scenarios) remained (the rights of inquiry as regulated in Title 8 of Book 2 Netherlands Civil Code was analysed in chapter 4).

5.5.5 Issuer's internal governance model focused on board's supremacy and discretion: some results

The previous paragraphs showed that the basic differences between the US and the EU can *prima facie* be illustrated by comparing shareholders' rights as attributed by the US MBCA and DGCL with the accumulated provisions of EU corporate law directives and national provisions. The MBCA and DGCL limit the (collective and individual) powers of 'shareholders' (remarkably and in contrast to the EU and MS, *not* using GMS as the notion of a body corporate) to a few major issues: appointment and dismissal of board members, mergers and consolidations, sales, leases or exchanges of all or substantially all of the corporation's property. EU and (examined) MS corporate law provides for a far more extensive list: such as appointment, dismissal and remuneration of directors, adoption of annual accounts and

853 Alain Pietrancosta, 'Enforcement of Corporate Governance Code', as Anton Philips Professor 2008-2009, Tilburg University: Oration: 2008-2009.

854 In the *ABNAMRO*-case the Amsterdam Business court de facto put the sale of La Salle on hold in the takeover fight for ABN. Interesting is the comparison with the UK, where, under the supervision of the Takeover Panel, tactical litigation is not allowed.

distribution of dividends from profit, discharge, appointment and assignment of external auditors, changes in capital and share issues, buy-back of shares, passing pre-emptive rights, legal merger, de-merger, dissolution, and change of substance and character of the firm, use of certain anti takeover devices (grant options on preferred protective shares). Similarly, provisions on boards, indemnification and insurance of its members, corporate reorganisations, exit rules (squeeze out, sell out and appraisal rights) reveal remarkable differences. Also in its substance shareholders' rights also differ in substance, such as UK and Dutch law provide for lower threshold for requiring GMS approval in case of fundamental changes to an issuer's charter or nature. In comparison with the other systems, the position of the GMS in the organisational model of the Dutch listed public corporation has been extended by extension of statutory shareholder's right, but also by the DCGC that seem merely to function as quasi-bylaws and sometimes surpass statutory law. The Dutch system provides some peculiar GMS rights, such as: adoption of the annual account and separate discharge of the board; separately discharge of the SB is required as well (Best Practise IV.1.6 DCGC; cf art. 2:102-3 NCC). Thus adoption of these accounts and determination of payable profits (dividends) can also take place without any GMS-resolution on discharge of BoM/SB. Consequently, the nature of the discharge seems to change direction according to a 'poll' of present and future strategy and policies, thus and to that extent extending the powers of shareholders in meeting and diminishing protection of board members. This differs from the other examined systems: in the US system where the director's right to statutory indemnification and protection of the BJR in a derivative suit shields the director from liability, the UK where the court has to allow a derivative suit and Germany where a new BJR has been introduced. As explained in chapter 4, the function of the right of inquiry in combination with the strengthened position of the GMS in the organisational design of the Dutch public corporation has a profound influence on the supremacy and discretion of the board.

5.5.5.1 Shareholder's procedural rights

Shareholders' procedural rights pre-meeting and also possibilities for (broad) enforcement, such as the right to rescind decisions of the GMS (but also of other organs of the company) determine the division of power between the board and the shareholders and also influence the supremacy of the board to execute its strategy and policy.

In the US, the rights of shareholder pre-meeting as well as the rescission right reflect the US market-oriented system aiming at protection of investors. The US board effectively controls the charter. US shareholders cannot vote on issues that are beyond their powers, since the board decides on matters related to the ordinary business. Shareholders do have the power to start a proxy contest or make (precatory) proposals.

The EU's (examined) MS all reflect their aim for minority protection. They all provide (under different thresholds) 'calling'-rights. In all systems, shareholders also have the right to put items on the agenda. The Netherlands so far provides a striking low threshold of 1% [or: the shares represent a value of 50 million EUR] for placing items on the agenda. All systems (especially the US and Germany), except the Netherlands, have similar discretion as the US board not to convene a meeting and to refuse to put an item on the agenda when it is related to ordinary business for example. Also the UK board, under certain conditions, has the power not to convene a meeting and to refuse a resolution that cannot be 'properly'

moved at the meeting. Notably, the board (BoM/SB) of a Dutch public corporation has less discretion not only in refusing to convene a meeting, but also in refusing to put a right on the agenda. In the Netherlands, shareholders' motions, unlike the US precatory rights, in practice function as a kind of instruction right, although case law has been overruled by the Supreme Court. Part of this mechanism is that DCGC-rules appear to be a certain extent enforceable as 'customary' rules (generally accepted principles) under the umbrella of its general corporate law principle that the internal affairs of a corporation shall be governed by reasonableness and fairness (art. 2:8 NCC, see chapter 4 for further analysis). The same applies to the requirement to have a dialogue with shareholders and therefore seems to be enforceable.
In Germany and the Netherlands, shareholders have a right to rescind a decision of the GMS but also other organs, if the decision has violated a statutory provision or a provision of the articles of association. However, because of abusive suits in Germany, the UMAG further developed the 'Spruchverfahren'-procedure. The German Spruchverfahren and rescission suit are two different procedures, and any claim that a compensation for shares is inadequate belongs to the domain of the 'Spruchverfahren'. The function of this 'Spruchverfahren' is quite similar to the US appraisal procedure (§ 262 (c) DGCL), as it prevents shareholders from blocking a transaction; it suits a market-oriented system in which investors are protected by giving them the right to have the fair value of their shares determined and paid to them in cash. The Dutch investigation procedure with the Enterprise Chamber also provides the possibility to void decisions of the GMS, but also of other organs of the company. The investigation procedure seems to largely absorb the normal rescission suit, although it does not offer the procedural clarity and safeguards of a regular contradictionary procedure. In case of issuers, these procedural differences had a profound influence on the supremacy of the Dutch board (listed public corporation). In chapter 4 these influences and other possibilities for shareholder's litigation were further discussed.

5.5.5.2 Combining shareholder's voting power: proxy solicitation and voting (corporate & securities law)

Proxy regulation can be part of securities regulation aiming at investor protection through disclosure. However these rules can also be part of a tradition of corporate/governance aiming at shareholder democracy and shareholders having a voice in the corporation. The former mainly emphasises the monitoring function of investors; the latter also aims at improving the shareholder voice as part of 'good' corporate governance.
US practice illustrates that a) incumbent management uses the proxy machinery to achieve a decisive power to vote on proposals presented by the board to shareholders, b) that the main focus is on appointment of members of the board (and incidental corporate reorganisations), c) that board's proposals may be contested by means of a proxy fight and d) that solicitation of proxies is regarded and regulated as a 'market transaction' (through *securities law* disclosure not intruding on the internal affairs of the corporation). The system is moulded into US securities regulation (securities acts/rules and *listing rules*) aiming at investor protection by disclosure.
In the EU/MS, proxy voting is part of traditional corporate law protecting shareholders in the corporation; the EU's Shareholder Rights Directive facilitating shareholder cross-border voting in the EU fits the Commission Action Plan 2003 corporate governance concept

of strengthening the position of shareholders in the corporation, also partly influenced by the LLSV study (par. 2.2). It is again remarkable that the EU, thus far, did not follow the US approach (of § 14 SEA'34) to regulate proxy solicitation primarily as a securities law 'market transaction' and provide for adequate disclosure by the solicitor of such proxies. Also, the examined MS approach this subject from a corporate law subject: proxy voting, as by now facilitated by a record date, is allowed in these jurisdictions; securities disclosure rules regulating proxy solicitation and voting aiming at investor protection under a (national) supervisor were not thus far introduced. Also the US-style mechanism/practice of management soliciting proxies is facilitated by UK and German law. However, in Germany only proxies with binding instructions are allowed (see default rule art. 10(3) Shareholder Rights Directive). Proxy solicitation by the management is not facilitated under Dutch law, however it is also not excluded. In the UK, the long-standing practice of the board to send out proxies still prevails.

5.5.6 Preliminary conclusions

Thus far, the results of the comparative analysis of shareholders' rights in the statutory charter of issuers seems to confirm the hypothesis that a) investor protection in the US is modelled primarily through high standards of initial and continuous disclosure, b) the protection does not come from extensive powers in the corporation's charter, c) that the division of powers indeed follows state rather than any federal corporate law (which is virtually nonexistent), d) that the corporation's charter is effectively controlled by the board, e) that the new EU securities law effectively results in US-style investor protection by introducing a US like disclosure system under public oversight, f) that, however, investor protection also continues to build on shareholders protection in the statutory charter and, at least to some extent, also by corporate governance codes, in the Netherlands in particular this led to a strengthened position of the GMS and (groups of) shareholders opposes to the board (BoM/SB) of the Dutch listed public corporation g) that this seem to explain the emergence of codes on corporate governance, h) that this does not seem to be the case only for Member States but also for the EU level that continues to build on the *acquis communautaire* without clearly singling out the charter for issuers and to follow and support the mechanism of soft law on governance.

5.6 Board supremacy and discretion in the context of investor's actions: the Dutch Right of Inquiry as unique action for activist shareholders

The HLG in 2002, in its report for modernising company law in the EU, advised providing shareholders with the right to apply to a court or appropriate administrative body to order a special investigation. A European framework rule should be adopted to this end (Recommendation III.8). The HLG places its proposal for an investigation procedure in the context of strengthening (minority) shareholders rights and their monitoring role as 'principal'. The HLG seemingly did not take into account the already evolving EU securities disclosure system under which issuers are required to provide investors on annual and interim basis with information and does not make a distinction between listed public and closed companies and states. The EC in its Action Plan 2003 for the medium term proposed enhancing the responsibilities of board members by special investigation rights, wrongful trading rules, and director's disqualification. However, the EC did not clarify its proposal. In chapter 4 it was demonstrated that the HLG's proposal of 2002 to introduce an investigation procedure, which in the Netherlands has gained experience over 40 years, at EU level should not be continued. This investigation entails in essence a broad review of corporate policy and is at odds with the securities disclosure system and as well with corporate law for (listed) public corporations. The analysis of chapter 4 also led to the conclusion that the Dutch right of inquiry should be re-examined.

As demonstrated in chapter 2, investor protection in the US as well as in the EU is primarily based on securities law disclosure, public oversight and enforcement both in the primary market (IPO) by prospectus liability and in the secondary market by securities fraud. The second layer of investor protection is found in the US, UK and German derivative suits, albeit under the protection of the BJR and hence focussing on its limits, i.e. breach of fiduciary duties. US (Delaware), German and also UK law, firmly establishes the principles of board supremacy and discretion. These are placed foremost where the board's business decisions are under attack (through claiming of damages; rescinding business decision however not in practice). The BJR protects the board by procedural requirements but also material by assuming the supremacy and discretion of the board. The burden of proof for breach of fiduciary duties is with the claimant. In the Netherlands, board members may be held liable through an art. 2:9 NCC procedure, but not derivatively. No BJR-rule will protect the board (members), although the standard ('ernstig verwijt') used in *that* procedure will, in its final outcome, not differ too much from the US, Germany and the UK, but does not provide the upfront protection of the BJR. The assessment does not – as the BJR does – start from a 'free zone' by assuming its basic discretionary business judgement. Thus it lacks the (upfront) certainty of the BJR-approach.

This approach of an upfront 'free discretionary zone' is also lacking in the Dutch investigation procedure. This procedure is unique and does not exist in the US, the UK or in Germany or – to my knowledge – in any other jurisdiction. The procedure is regulated in NCC Book 2 in Title 8: Dispute resolution by compulsory transfer of shares or compulsory acquisition of shares, and *the right of investigation*. The provisions on the right to request an investigation are laid down in arts. 2:344-359 NCC. The competent court is the Enterprise Chamber of the Amsterdam Court of Appeal (Enterprise Chamber). The procedure is divided into two steps. First, shareholders may petition for an investigation into the corporation's affairs in a certain period if the court is satisfied that there are well-founded reasons to doubt good policy (proper administration) of the corporation. Secondly, shareholders may request for a judgement of the court if the report produced after the investigation shows that there has been 'mismanagement of the legal person' and – if the court so concludes – to order specific injunctions (including replacement of the board). This procedure allows – also for issuers – immediate and final injunctive relief (arts. 2:349a and 355 NCC) if, according to the court, the state of affairs so require. In recent years, as discussed in chapter 4, this procedure and the possibility for (immediate) injunctive relief has developed into a very accessible, quick and extremely effective weapon for activist shareholders, especially in formal or material takeover conflicts and to put pressure on boards to change strategy and policy (break up scenario, buy-backs, exit appraisal) and thus to challenge board supremacy and discretion as well as to 'provoke' a judicial review of its strategy, policies and actions. One could say that this procedure evolved towards a quasi-derivative suit, at least to the extent that a preliminary judgement may be acquired as to 'misconduct' of the board to be used in a subsequent action (art. 2:9 NCC), which evidently may also provide 'leverage' in settlement negotiations. The most remarkable element of the investigation procedure is its effectively unlimited possibility to review board action. It is not surprising that in practice classical suits for rescission *ex post* of corporate decisions became extremely rare. In the US, business decisions as such are also protected by the BJR.

My next hypothesis is that board supremacy and discretion of the board of Dutch issuers eroded remarkably over the last decade (being re-established only very recently by the Supreme Court), due to the fact that this investigation procedure has not been the subject of a fundamental review in the total change of the regulatory landscape for issuers and remained a corporate law procedure not taking into account the fundamental change in securities law.[855] This investigation procedure and its declared, but seemingly outdated purposes will be tested and contrasted to the separate 'layers' of investor's protection offered by the completely revised EU and Dutch securities regulation, again in comparison with the US, EU, UK and Germany. Again I suggest the reader compare the tables as provided in the Annexes.

5.6.1 Purposes of the Rights of Inquiry tested against investors' actions in the examined systems

The implementation of the Prospectus, Transparency, Takeover and Market Abuse Directives argue for contemplation on private law devices as a whole in enforcing the 'new' securities regulation; the right of inquiry in its unique set-up as being only available for a Dutch listed public corporation in protecting the interest of investors has not been involved in that contemplation.[856] The right of inquiry still comes in addition to other available actions. It offers the Enterprise Chamber room for its own forming of the law, but taking into account its general character it does not give any direction to the embedment in the total regime of corporate and securities law for listed public corporations in the Netherlands. In comparison, the other examined systems (as we will see) have a different 'hands-off' judgement.

The 40-year-old general purposes: 1) bringing matters in the open, 2) restructuring and restoration of sounds relations by means of measures that serve to reorganize the enterprise of the legal person concerned, 3) establishing responsibility for mismanagement that

855 Of course the Supreme Court in *ABNAMRO* and *AMSI* reconfirmed the supremacy and discretion of the Netherlands Board (BoM/SB), nonetheless the procedural structure of the inquiry procedure almost automatically leads to substantial board review.

856 The plea (November 2002) by the HLG (with Jaap Winter as its chair) for developing a European action has so far been without results; Corporate Governance Action Plan (21-05-2003); Klaus Hopt, 'Modern Company and Capital Market Problems: Improving European Corporate Governance after Enron', in Armour/McCahery (red.), *After Enron, Improving Corporate Law and Modernising Securities Regulation in Europe and the US, p. 466.* In my view Hopt's position that the 'investigation'-procedures in France, Germany and Denmark as discussed are similar to the Dutch right of inquiry is inaccurate. Where he discusses the protection of the German BJR, he overlooks the fact that the BJR in Netherlands is not provided for; in his argumentation related to information asymmetry he ignores the strengthened disclosure obligations under European securities regulation.

may exist, and 4) prevention of the right of inquiry in my view no longer fit in the fundamentally changed corporate and securities law regime for listed public corporations.

5.6.2 'Bringing matters into the open' and investor protection through securities – and/or corporate law: EU and US

If we take again the purpose of 'bringing matters into the open' as ground for an inquiry request, then the question concerning the meaning of that for listed public corporations (NV) should be answered by searching for the context of the (re)newed European Securities Law as implemented in the Netherlands AFS. As already extensively analysed in chapter 2 the capital market (shares) and investors in these markets are primarily protected by severe and heavily extended securities law as placed under public supervision. This makes in my view 'bringing matters into the open' as a ground for the right of inquiry related to Dutch public listed public corporations obsolete.
Thus for retaining previous possible difficult information, which the issuer now has to make public on grounds of securities regulation, (minority) shareholders do not necessarily need the right of inquiry anymore. That this is not very illogical illustrates the German amendments to the rescission suit, because, having broad information rights under the AktG, shareholders abused these actions to get a higher exit price such as in case of a freeze out; the Spruchverfahren-procedure was further evolved.
Furthermore, in all systems investors are provided with an action to claim their damages on the issuer itself that they (whether or not as class) suffer on the ground of misleading information by breach of securities disclosure requirements, whether by (initial or subsequent) issue of securities (shares) by a misleading prospectus, or continuous and interim information requirements (annual reports, quarterly and interim announcements): such as in the Netherlands art. 6:193a NCC, US SEA'34 Rule 10-b5 vervangen door Rule 10b-5 SEA'34, § 37b WpHG and § 90 FSMA (see chapter 2 for further elaboration). A role for the right of inquiry in the above described context seemingly lacks any purpose.

5.6.3 Establishing responsibility for mismanagement on the part of the corporation and (derivative) actions of the corporation towards its board members

At the next level of private law protection for investors is the action of the corporation (issuer) itself, as represented by its board, against its (previous) directors (BoM/SB) in collecting compensation for damages (and thereby – indirectly – its investors).
The Dutch ground for this general contradictionary claim (part of Book 2 on legal persons) is 'improper management/supervision' (art. 2:9 NCC). It is not directed towards directors of entrepreneurial legal entities, and not least on public listed companies. A BJR, as known in the US and Germany, in which the business judgement of the board (BoM/SB) in a liability suit will be honoured by the court as principle starting point (this will only change for a breach of duties of loyalty and – more gradually – of duties of care) is not (yet) provided for in Dutch law. In accordance with the decision of the Supreme Court in the *Staleman* –case, a claim under the in that case operated catalogues will only be granted in case of 'serious reproach'. This does not involve a BJR since its crucial 'hands-off' starting point is lacking. Also these topics and their relation to the right of inquiry upon introduction of the new securities regulation are not recalibrated.

Although establishing who is responsible for 'mismanagement' is still, also for listed public corporations, a recognised purpose of the right of inquiry, the procedure is not equipped for that. Nonetheless, a request for an inquiry is sometimes clearly directed towards (the preparation of) a liability suit. The purpose of the right of inquiry handled here applies to the final judgement of'mismanagement of the corporation' (art. 2:355 NCC) after the total procedure has ended. Even that judgement is not a judgement on 'improper governance/management or supervision' of individual board members or commissioners. A fortiori this applies to the judgement, as to whether there are well-founded reasons to doubt good policy. However, practice is different.

5.6.4 The investigation procedure as quasi-liability action?

The admittance to the inquiry procedure, however, does not provide for the same threshold as in the Delaware, UK and German derivative suit (*demand or Vorferfahren).* These pre-procedures effectively serve to protect the corporation and its board from 'frivolous actions (§ 327 DGCL and §§ 7.40 – 7.47 MBCA; § 7.01 ALI Principles; secs. 260-264 UK CA 2006; sec. 261 (1) UK CA 2006; §§ 147-149 AktG). In these derivative suits, the board's supremacy and discretion are put foremost as protected by a BJR. These aforementioned principles underpin the position of and (core) assignment of the board of a (listed) public corporation; these are not fundamentally different in the US, UK, Germany or the Netherlands. In these systems, statutory law expressing the supremacy and discretion of the board underpins BJR's protection: § 141a DGCL, § 76 (1) AktG, also UK Model Articles provide these principles. In the Netherlands, a statutory rule (see art. 2:129 NCC: management of the corporation) rooted normative principle and point of departure recognising the discretionary powers of the board is lacking. However jurisprudence explicitly confirms that rule (Supreme Court in *Forum-Bank ABNAMRO* and *ASMI*.)

However, the BJR, also in the examined systems, does not provide 'carte blanche'. The judiciary will abstain from 'second guessing' the board's business judgement, but will review non-observance of fiduciary duties of care (primarily focussing on the process of decision-making and seldom leading to liability) and duties of loyalty (focussing on decent 'non-selfish' behaviour as 'trustee' and – if proved by plaintiff – usually upheld in court). The BJR provides that, in the judgement of the complaint, the court will honour the *business judgement* of the board, will refrain from judging with wisdom of hindsight and will not place its own judgement instead of the board. (will not sit on the 'chair' of the board). The BJR is also the point of departure in the first (demand) phase of a *derivative suit*. '*Fishing expeditions*', aimed at 'discovery', and also intervening through immediate measures (injunctions; orders by the court) will be stopped.

In the inquiry procedure a similar 'hands-off' approach protecting principles of board supremacy and discretion is missing. The procedural safeguards provided by a contradictionary procedure to the corporation and its board (BoM/SB), are lacking and with that the typical obligation to state facts, the burden to prove, hearing both sides, a written debate between parties with a usual exchange of statements (of claim and of defence). The safeguards of a pre-procedure (demand and Vorferfahren) are also missing. A court in the last names art. 2:9 NCC-procedure will not be strictly bound to a final judgement of an inquiry procedure, however it will have pre-judicial working. The Enterprise Chamber, in giving a decision on the initial request or in taking immediate measures (arts. 2:350 and 3:349a

NCC), has often already made (disqualifying) judgements on policy and operation. This does not provide a similar 'hands-off' approach as is the case in the derivate suit entailing that only breach of duties of loyalty or clear breach of 'duties of care' should be postulated, proved and judged.

5.6.5 Restructuring and restoration of sound relation in a listed public corporation (N.V.)

As demonstrated in chapter 4, the last purpose of an inquiry procedure is restructuring and restoration of sound relations in a listed public corporation (N.V.), which does not seem to fit for a listed public corporation. The corporation is allowed to structure its own organisation, limited by mandatory law, according to its own view. The corporation will go public (IPO) as such under its prevailing governance system: division of tasks and powers between the board (BoM/SB) and the GMS, adherence to corporate governance codes, oligarchic regulations, anti-takeover devices and the rights (control, right on dividends and liquidation – and transfer worth) connected to the securities (shares) that are being offered. As demonstrated in chapter 3, investors as shareholders are also protected by collective and individual statutory rights (following the law and articles of incorporation).
Under this pattern for listed public corporation, in which, for example, the rescission of decisions also offers important ex ante protection, restructuring and restoration of sound relations offers the listed public corporation no good manageable focus point. The clearest attack that investors can make on the corporation (NV) is that statutory organisational rules or organisational rules as part of the articles of incorporation (US = bylaws, UK = articles) have been breached (NCGC) resulting in rescinding decisions (art. 2:15) or possible liability on grounds of art. 2:9 NCC. However, the Chamber of Business, often paying lip service to the supremacy of the board often on grounds of art. 2:8 NCC, has filled in or extended organisational rules and subsequently determined a breach of these rules. Chapter 4 provided some examples: a) the broad explanation of art. 2:107a NCC in the *LaSalle*-transaction (*ABNAMRO* and explained under chapter 3; b) the 'duty' for (continued) dialogue with investors (*Stork*, *ASMI*); c) the duty of the SB to negotiate (*Stork, ASMI*).
Thus the last purpose of the right of inquiry does not give clear focus and guidance. For listed public corporations in particular, their open character makes internal governance and the implications thereof easily distinguishable for all investors without studying the Dutch right of inquiry. For the listed public corporation itself that is also important.

5.6.6 The Netherlands Supreme Court reverses the switch for the right of inquiry related to listed public corporations; The investigation procedure for issuers and HLG-recommendation (2002) to be reconsidered.

Although (still) confirming the original aims and ends of the investigation procedure as discussed in chapter 4, the Netherlands Supreme Court overruled a series of decrees of the Enterprise Chamber in investigation procedures initiated by (activist) investors against Dutch issuers. Its decisions in *DSM*, *KPN/Qwest*, *ABNAMRO* and the *landmark decision* in *ASMI* taken together has now established quite clear guidance on major issues such as the entry to the procedure and on intermediate 'stop orders', and, most importantly, reconfirmed the issuer's board supremacy and discretion.

In the absence of a *stare decisis*-rule however, this, is not binding the Enterprise Chamber. Thus, a re-assessment of the basic statutory rules, taking stock of both the introduction of the protection of investors by the new securities regulation, the DCGC and the rulings of the Supreme Court is necessary.
The *ASMI* – case most clearly has reconfirmed the supremacy and discretion of an issuer's board by establishing that a corporation's strategy falls within the discretion of the board also in judging whether it is desirable to have a consultation with external shareholders: thus no obligation for consultation, also not on the ground of extensively interpreted 'governance'-rule. In my opinion the Supreme Court in *ASMI* itself 'restored relations' in the internal affairs of issuers and restricted the admission to the investigation procedure, the effect of which is somewhat akin to that of the BJR. One could observe that thus a '*level playing field'* with the other examined jurisdictions had been restored and the investigation procedure is better embedded in the total regime for issuers of securities and corporate regulation and enforcement mechanisms (transparency, disclosure, auditor's control, internal monitoring, appointment/resignation, rescission of decisions). Nonetheless, I find that the reconfirmation of board supremacy, strengthening of the obligation to motivate and 'hearing' the corporation itself, not only strongly increases the threshold, but also substantive 'second guessing' by the Enterprise Chamber maybe does not exclude but in any case severely hinders it. The security of a statutory BJR is, however, lacking. *ASMI* also confirms the issuer's freedom of organisation to include the power to protect itself *ex ante* against a takeover of control or factual control. From a securities law point of view the issuer shall evidently fully disclose such devices.[857] Remarkably, the fact that *ASMI* had done so was virtually ignored by the Enterprise Chamber. Thus, the Supreme Court in *ASMI* effectively strongly conditioned the application of the investigation procedure against issuers.
The *ASMI*-decision of the Dutch Supreme Court takes away a lot of uncertainty, however it does not provide certainty in answering the many questions that will rise when applying to right of inquiry as still governed by its open purposes, especially in taking immediate measures and in using the right of inquiry as a quasi-liability procedure. Therefore, it does not seem illogical to exclude the right of inquiry for listed public corporations. The international familiar regime for private law devices for listed public corporations is mainly underpinned by securities fraud – and liability actions. If one should choose to eliminate the right of inquiry for listed public corporations, then it seems to be logical to introduce it as a derivative action and also in that respect to connect with the international regular regime for listed public corporations. German law provides a continental example of this.

5.7 Final observations

Going back to where I started I recall the observations by Hansmann & Kraakman on global convergence of public corporations towards a shareholder primacy model. This transat-

857 See also chapter 2 on the working of the capital market and the ECMH. The Enterprise Chamber overlooked the defence of ASMI that such disclosure had taken place in the issuing and admission prospectus when extended its listing on NASDAQ (NY) to the exchange of Amsterdam.

lantic comparative analysis, excluding BRIC and other emerging markets, showed that history reveals another route. Closer analysis reveals some major conceptual elements: a) the long-standing and clear dichotomy in the US between securities and corporate law and b) the primary focus of securities regulation on investor protection and market transparency, c) the crucial meaning of the well-defined term 'issuer' as the basic addressee of securities law, d) the very modest role of corporate law to protect investors. From a US perspective these conceptualise the basic ideas of 'firms' and issuers. It explains the US limited regulatory response to 'Enronitis' in the framework of the issuer and market-addressed securities regulation.

Hansman and Kraakman in part reflected upon the HLG Report of 2002 that on the one hand underscored the emerging EU securities regulation as a separate body of EU law and, in doing so, seemed to contribute to a convergence towards a US-style (global) securities regulation and, hence, a standard model for issuers. On the other hand, in hindsight, the HLG seem to have overlooked the basic meaning of the dichotomy between corporate and securities law and consciously to have broadened their analysis to (harmonisation) of classical corporate law subjects, such as on investigation rights. The response of the EC, not surprisingly, focused on preserving the *acquis communautaire* in corporate law. This research may have illustrated that in comparison with the US system the EU does not operate the same dichotomy between federal securities and state corporate law. Starting from that point, developments show on the one hand the emergence of a standalone US-style EU securities law, but on the other hand the existing overlap with corporate law (disclosure, GMS and shareholders, board supremacy and discretion, corporate governance codes, takeover bids, private and public enforcement).

The lack of a clear demarcation between securities and corporate law protection may be expected to continue to divert regulatory choices and responses to new developments. Similarly, it will continue to influence the position of (boards of) issuers and protection and enforcement powers of investors and shareholders in a way that will continue to reveal important differences within the EU and in comparison to the US. There seems no indication, so far, that the EU will choose to focus completely on securities law addressed at issuers and protection for investors and leave – in the US – corporate law to jurisdictional competition.

Moreover, major differences were revealed by comparing jurisdictions within the EU with for example, the Dutch investigation procedure as a shining example of extending investor enforcement power in issuers. The UK and Germany seem to go further in aligning with the dichotomy.

Nevertheless, converging securities law regime at EU level remains crucial to market integration and regulatory competition and arbitrage. Market regulation and investor protection being focussed *on issuers* rather than corporations may be helpful in the furthering of these objectives.

Annex I:
Securities Regulation Basics[1]

1 Annex I is accompanying chapter 2 and entails a basic comparison of securities regulation. Annex II is accompanying chapter 3 and entails a comparison of Powers of General Meeting of Shareholders; Group and Individual Rights of shareholders.

Table Securities Regulation Basics:

	SA'33	SEA'34	European Regulation/Directives	The Netherlands: AFS (Wft)
Initial Public Offering; Obligation to make a prospectus available	§ 5 provides that no security may be offered or sold to the public unless it is registered with the SEC; the registration statement consists of two parts: Part I. the prospectus, a copy of which must be furnished to every purchaser of the securities, and Part II, containing information and exhibits which need not be furnished to purchasers but are available for public inspection in the Commission's files; § 7, by reference to Schedule A of the Act for information to be included in Registration Statement; § 10 (a) (1) provides those items that has to be included in the prospectus furnished to purchasers.		art. 3 (1) Prospectus Directive (2003/71/EC), MS shall not allow any offer of securities to be made to the public within their territories without prior publication of a prospectus; Art. 3 (3) MS shall ensure that any admission of securities to trading on a regulated market situated or operating within their territories is subject to the publication of a prospectus; art. 5, the prospectus shall contain all information which, according to the particular nature of the issuer and of the securites offered to the public or admitted to trading on a regulated market, is necessary to enable investors to make an informed assessment of the situation of the issuer and of the rights attaching to such securities; see the Commission Regulation Prospectus Directive (EC, No. 809/2004) concerning information contained in prospectuses as well as the format, incorporation by reference and publication of such prospectuses and dissemination of advertisements	art. 5:2, it is forbidden in the Netherlands to offer securities to the public or to admit to trading on a regulated market situated or operating in the Netherlands, unless a prospectus is generally available, which was approved by the AFM or a supervisor of another MS; art. 5:12 – 5:19 for information to be included in the prospectus.
Continuous disclosure		§ 12, requires issuers (and other companies) which have a class of securities traded on a national exchange to register with the SEC; therefore SEA'34 disclosure requirements apply to issuers that, § 12 (a), have a class of securities listed on a national securities exchange, (b), have assets in excess of $ 10 million and (c) have a class of equity securities held by a least 500 persons; § 12 requires further the filing of a detailed statement about the company when it first registers under the '34 Act, and § 13 requires a registered company to file with SEC "such annual reports.. and such quarterly reports..as the Commission may prescribe." The basic report required to be filed with thee SEC under § 13 are (a) an annual report on Form 10-K, (b) a quarterly report on Form 10-Q, and (c) a current report on Form 8-K for any month in which certain specified events occur.	art. 1 Transparency Dir., states the subject matter and scope of the Transparency Dir., that is establishing requirements in relation to the disclosure of periodic and on-going information about issuers whose securities are already admitted to trading on a regulated market situated or operating within a MS; art. 2 (1) (d), 'issuer' means a legal entity..., whose securities are admitted to trading a regulated market; art. 3, MS may impose requirements that are more stringent than the Dir., but host MS may not; art. 4, issuers shall disclose their annual financial report, arts.5 and 6, their half year and other interim statements; art. 19 and 24, disclosure documents shall be filed with the national competent authority as designated.	art. 5:25b, this section only applies to issuers whose securities are admitted to a regulated market and whose home Member State is the Netherlands; art. 5:25c, within four months after the financial year, the issuer will disclose its drawn-up annual financial reports (annual accounts as audited by an accountant, the annual report, certification of responsible persons within the issuer); art. 5:25 (d) (1), as soon as possible and no later than two months after the first six months of the year an issuer shall draw up the half yearly financial report and disclose this to the public.

Market abuse: insider trading		Rule 13a-11, Form 8-K, current report on Form 8-K: 'a report on this form is required to be filed or furnished, as applicable, upon the occurrence of any one or more of the events specified in the items in Section 1-6 and 9 of this form. Unless otherwise specified, a report is to be filed or furnished within four business days after occurrence of the event'; § 202.05 NYSE Listed Company Manual, listed firms shall release promptly any news or information that might reasonably be expected to materially affect the market for its securities; insider trading is mainly defined in enforcing these frauduleus practises under § 10(b) and Rule 10b-5. Rule 10b-5 prohibits any fraudulent or manipulative device in connection with the purchase or sale of a security. This has been interpreted to bar most kinds of insider trading (see further under 'securities fraud');§ 16 (b) is designed to minimize the unfair use of inside information. Under that section, profits made by insiders from transactions involving equity securities of publicly held companies, when a purchase and a sale are made less than six months apart, must be disgorged and paid over to the issuer, see also § 16 (a) for requirement for 10% security holders, directors and officers of the issuer to file to file reports with the SEC/exchanges concerning their holdings of all equity securities of such issuers; see also §§ 20A and 21A.	art. 6 Market Abuse Dir. (2003/6/EC), MS shall ensure that issuers of financial instruments inform the public as soon as possible of inside information which directly concerns the said issuers; art. 1, 'inside information: 'information of a precise nature, which not has been made public, relating, directly or indirectly, to one or more issuers of financial instruments or to one or more financial instruments and which, if it were made public, would be likely to have a significant effect on the prices of those financial instruments..'.	art. 5:25h, an issuer whose shares are admitted to trading on a regulated market shall promptly disclose information about changes in the rights attaching to its issued shares of a given class; art. 5:25i (2), an issuer discloses promptly information referred to in the definition of insider information in art. 5:53 (1) and which relates directly to the issuer; art. 5:53 (1), insider information: 'familiar with information that is concrete and directly or indirectly relates to an issuer, on which the financial instruments are related to or concerning the trade in these financial instruments, which information has not been disclosed and that disclosure significantly could affect the price of the financial instruments or the price of related derivative financial instruments'.

Proxy solicitation		§ 14 makes it unlawful for a company registered under § 12 to solicit proxies from its shareholders "in contravention of such rules and regulations as the SEC may prescribe as necessary or appropriate in the public interest or for the protection of investors;§ 14 (a), it shall be unlawful for any person to use interstate facilities to solicit or to permit the use of his name to solicit any proxy or consent or authorization in respect of any security registered pursuant to section 12; see Schedule 14A for information that must contained in the proxy statement; Rules 14a-3 and 14c-3, when proxies are being solicited for use at an annual meeting for election of directors, the proxy statement must be accompanied by an annual report containing comparative financial statements for the last two fiscal years and other specified information.		
Acquiring of certain stake of shares		§ 13 (d)(1), any person (or group) that becomes the owner (directly or indirectly) of more than 5% of the issuer (registered under § 12) must file with the issuer of the securities, and with the SEC, within 10 days, a statement setting forth a) the background of such person, b0 the source of the funds used for the acquisition, c) the purpose of the acquisition, d) the number of shares owned, and e) any relevant contracts, arrangements or understandings; see Schedule 13D for the resulting disclosure designed to give management of the issuer information concerning potential tender offerors.	art. 9 Transparency Dir., 'the home MS shall ensure that, where a shareholder acquires or disposes of shares of an issuer whose shares are admitted to trading on a regulated market and to which voting rights are attached, such shareholder notifies the issuer of the proportion of voting rights of the issuer held by the shareholders as a result of the acquisition or disposal where that proportion reaches, exceeds or falls below the thresholds of 5%, 10%, 15%, 20%, 30%, 50% and 75%…'.	art. 5:38 (1), everyone who has or acquires a certain percentage of shares (art. 5:58 (2), thresholds = 5%, 10%, 15%, 20%, 25%, 30%, 40%, 50%, 60%, 75% and 95%)or, art. 5:39 (1), voting rights has to promptly notify the AFM; art. 5:34 (1), see also notification duty for the issuer when changes in its capital of more than 1% related to a previous notification.
Groups acting in concert		§ 13(d)(3), duty to file also applies to groups, i.e. persons acting in concert; § 13 (d) (3), 'when two or more persons act as a partnership, limited partnership, syndicate, or other group for the purpose of acquiring, holding, or disposing of securities of an issuer, such syndicate or group shall be deemed a person, for the purposes of this subsection'.	art. 10 Transparency Dir., the notification requirements of art. 9 shall also apply to a natural person or a legal entity to the extent it is entitled to acquire, to dispose of, or to exercise voting rights in amongst other a) voting rights held by a third party with whom that person or entity has concluded an agreement which obliges them for concerted action towards the management of the issuer ('lasting common policy')	Art. 5:45 someone is considered to have control over shares/votes held by a third person with whom he has made an agreement to act in concert (durable common policy) concerning the exercise of the voting right.

Tender offers/public biddings		§ 14 (d), no person may make a tender offer which would result in his owning more than 5% of a class or securities registered under § 12 unless he has filed with the SEC, and furnishes to each offeree, a statement containing certain of the information required under § 13 (d), plus any documents used to solicit or advertise for tenders (see above); §§ 14(d) and (e), and the rules adopted by the SEC under them, also impose significant substantive restrictions on the terms of tender offers.	art. 6 (1) (2) Takeover Dir., requires that a decision to make a bid is made public without delay and that an offeror is required to draw up and make public in good time an offer document containing the information necessary to enable the holders of the offeree company's securities to reach a properly informed decision on the bid; art. 6 (3) for required in offer doc.; art. 8 (1), 'MS shall ensure that a bid is made public in such a way as to ensure that a bid is made public in such a way as to ensure market transparency and integrity for the securities of the offeree company, of the offeror or of any other company affected by the bid.....'.	Art. 5:74 (1), no party may make a public takeover bid for securities admitted to trading on a regulated market, unless an offer document approved by the AFM or by a supervisory authority of another MS has been made generally available prior to the takeover bid; art. 5:76 and sec. 8 Decree, the offer doc. must contain all information that is necessary and material for a reasonable informed and careful person to make a well-considered , the assessment of the bid; art. 5:78, the offeror shall make its bid by making the approval of the offer doc (after 6 days) generally available.
Mandatory bid			art. 5 Takeover Dir., a mandatory bid has to be made upon acquisition of effective control, which is assumed upon passing a certain threshold. (= 30% of the voting capital in most MS)	art. 5:70, every person that acting alone or in concert with others, who directly or indirectly, acquires effective control (assumed at 30% or more) in a Netherlands limited liability company, with its seat in the Netherlands, whose shares or certificates are admitted to trading on a regulated market, shall make a public offer for all outstanding (certificates of) shares and shall announce this immediately, art. 5:72, after 30 days.
Non-frustration and Breakthrough Rule			art. 9 Takeover Dir. provides an optional rule that requires the board of the offeree company to obtain the prior authorization of the GMS for any action which may result in the frustration of the bid; art. 11, any restrictions on the transfer of securities provided for in the art. of association (or in contractual agreements) of the offeree company shall not apply vis-à-vis the offeror during the time allowed for acceptance of the bid laid down in art. 7(1).	art. 359 (a) (b), issuers are allowed to restrict themselves in their art. of association to protect themselves and their freedom of action after a takeover bid for their shares has been formally announced, meaning: non-frustrating actions, involvement of the GMS to activate ex ante protective devices, to lift restrictions on voting on or transfer of shares and to allow an offeror that acquired 75% or more or force a break through by calling a GMS in which only holders of ordinary shares may vote; art. 2:359 (b) (4), allows an issuer to neutralize such rules where the offeror has no similar provisions its own art. of association (reciprocity).

Enforcement				
General securities fraud		§ 10 (b) and Rule 10b-5, it shall be unlawful for any person using interstate facilities a) to employ any device, scheme, or artifice to defraud, b) to make any untrue statement of a material fact or to omit to state a material fact necesary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or, c) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.		art. 6:162 NCC, general tort action; cf. also art. 2:150 NCC, if the annual accounts give a misleading representation of the state of the company, the commissioners next to the directors are liable to third parties for the damages suffered by them as a result.
Prospectus liability	§ 11 provides a civil remedy in the case of a registration statement that contains : 'an untrue statement of a material fact or omit(s) to state a material fact required to be stated therein or necessary to make the statements therein not misleading.'; § 12(a) (1), provides for civil liability when a person 'offers or sells a security in violation of section 5,'that is, when unregistered securities are offered or sold without an exemption; § 12 (a) (2) provides that any person who offers or sells a security, by 'means of a prospectus or oral communication' that includes a material misstatements or omission, is liable to his or her purchases for rescission or damages.		art. 6 (1) Prospectus Dir. leaves the responsibility for enforcing the dir. to the MS: 'MS shall ensure that responsibility for the information given in a prospectus attaches at least to the issuer or its administrative, management or supervisory bodies, the offeror, the person asking for the admission to trading on a regulated market or the guarantor, as the case may be..', and art. 6 (2), 'MS shall ensure that their laws, regulation and administrative provisions on civil liability apply to those persons responsible for the information given in a prospectus.'	art. 6:193a – 194 NCC; arts. 6:193b and 6:193a NCC, a trader is acting unlawfully against a consumer if he carries out a commercial practice that is unfair. Among them would include misleading consumers by providing of information that is factually inaccurate or that the average consumer may mislead or deceive, whether or not by the general presentation of that information.

Annexe II: Powers of General Meeting of Shareholders; Group and Individual Rights of shareholders

Table

	RMBCA	Delaware General Corporation law	European Corporate law	Netherlands Civil Code, Book 2 and DCGC	UK CA 2006 and Com.Code	GER AktG and Cromme Code
PROCEDURAL REQUIREMENTS RELATED TO GMS						
Notice of meeting	§ 7.05 (a) (b), corporation shall notify SH entitled to vote of date, time and place of each annual and special meeting not fewer than 10 nor more than 60 days before the meeting date, unless articles require otherwise, (c) notice of special meeting must include a description of the purpose or purposes for which the meeting is called.	§ 222, (b)written notice is given between 10 and 60 days before meeting; (a) notice of special meeting must include a description of the purpose or purposes for which the meeting is called.	art. 5 (1) Shareholder Rights Dir., MS shall ensure that the company issues the convocation of the GMS not later than on the 21st day before the day of the meeting, in case of electronic voting no later than on the 14th day, (3) the convocation shal at least (a) indicate, place and time and the agenda of the meeting; (b) contain a clear description of the procedures that shareholders must comply with in order to be able to participate and to cast their vote in the GMS.	art. 2:133 (1) (2) (4) and (5), notice through announce-ment in nation wide newspaper or through electronic means, art.2:115 at least 15 days for the meeting, no legally valid resolution may be passed, except by unanimous vote at a meeting at which the entire issued capital is represented when no notice was given or issued to late.	sec. 307 (2), a general meeting of a public company must be called by notice of (a) in the case of an annual general meeting, at least 21 days, and (b) in any other case, at least 14 days, (3) the company's articles may require a longer period of notice than that specified in subsection (1) or (2).	§ 121 (4) in case of registered shares, SH should be informed by letter when the articles don't provide for another procedure; § 125 (2) in case of registered shares notice in two weeks before the meeting is required, § 121 (3), in case of bearer shares announcement should be made public through the Gesellschaftsblätteren'; see also § 25 AktG.
Record date	§ 7.07 (a), bylaws may fix record date, not more than *70 days* for meeting. If bylaws don't provide for a record date the board is allowed to set this date.	§ 223 (1), Board is authorized to fix a record date between 60-10 days for the meeting.	§ 7 (1) (a) (b) Shareholder Rights Dir., shares not blocked (transferability and depository obligation)before meeting, (2) MS provide for record date on which rights of SH to participate and vote in GMS are determined, (3) at leat 30 days before GMS and 8 days between latest date of notice and record date.	art. 2:119, BoM as authorized by SH (5 years maxumum or according to the art. of incorp. for indefinite time) to set record date at least 30 days before meeting. *(under Bill 31 746, 28 days).*	reg. 41 (1) Uncertificated Securities Regulations 2001 (SI 2001/3755), record date is set at not more than 48 hours before the meeting.	§ 123 (2), SH who hold 21 days prior to the meeting shares in their bank account under their own name at the relevant record date are entitled to exercise their shareholder rights at the meeting.

Quorum requirements	§ 7.25 (a), default quorum is a majority of the shares entitled to vote, altough the art. of incorp.(§§ 7.25 (d) and 7.27) can specify either a higher or a lower figure; § 7.25 (c), action on matter..is approved if the votes cast..favoring the action exceed the vostees cast opposing that action; art. of incorp. may require a higher vote than the deafult statutory minimum, also certain extraordinary action require approval by a higher vote, e.g. § 10.03 requires that alteration of the art. of incorp. be approved by a majority of the shares entitled to vote.cf. § 11.04 (merger) and § 12.02 sale of all or substantially all the corporation's assets; § 7.28 (a) directors are chosen by a plurality vote.	§ 216, same as § 7.25 MBCA, only difference the requirement, in no event shall a quorum consist of less than one-third of the shares entitled to vote at the meeting; § 216, in the absence of such specification in the certificate of incorporation or bylaws of the corporation: (1) a majority of the shares entitled to vote, shall constitute a quorum; (2) in all matters other than the election of directors, the affirmative vote of the majority of shares *present* (cf. § 7.25(c)) shall be the act of the stockholders; § 216 (3) directors shall be elected by a plurality of the votes of the shares present... (cf. § 141 (b)) allows for majority vote electing directors in stead of the former plurality vote.		art. 2:120, no quorum, majority of votes present at meeting, (2) unless the statute or articles provide otherwise, see e.g sometimes 2/3,3/4 quorum required art. 96a.	sec. 281 (3), ordinary resolution is one passed by a simple majority of those entitled to vote, articles may specify a higher level of approval, up to and including unanimity;§ 283 (1), a special resolution of the members of a company means a resolution passed by a majority of not less than 75%,(2), a written resolution is passed by a majority of not less than 75% if it is passed by members representing not less than 75% of the total voting rights of eligible members.	§ 133 (1) in principle a relative (simple) majority is required unless required differently by statute or articles; cf.§ 179 (2).
Proxies	§ 7.22.(a), SH may vote their shares by proxy, (c) a proxy is valid when received by corporation, § 7.22 (d) Proxy is irrevocable unless stated otherwise.	§ 212 (b) each shareholder which is entitled to vote may appoint a proxy; 212 (e), proxy can be irrevoca-ble.	art. 10 (1) Shareholder Rights Dir., a shareholder shall have the right to appoint a proxy holder to attend and vote at a general meeting in his name; the proxy shall enjoy the same rights to speak and aks questions in the GMS as the shareholder represented.	art. 2:117 lid 1, a shareholder may vote by proxy; a proxy has the same rights as the proxy in meeting; the articles may restrict the right of shareholders to have themselves represented; the articles may not exclude the right of shareholders to have themselves represented by amongst others a attorney-at-law; art. 117a by now also enables electronic voting if allowed by the art. of incorp.	sec. 324 (1), any member is entitled to appoint another person as his proxy to attend, speak and vote instead of himself at a meeting of the company.	§ 134 (3) voting by proxy is possible, without setting limits on its duration or the person of the proxy;§134 (3) (s.2) eletronic proxies are wllowed.

POWERS OF GENERAL MEETING OF SHAREHOLDERS						
Appointment of directors	§ 8.03 (c), • at first GMS; • each GMS thereafter; § 8.06 for staggered boards; § 7.28 (a) unless otherwise provided in the articles, directors are elected with a plurality vote at a meeting at which quorum is present, (b) shareholders can only cumulate their votes if so provided by the articles.	§ 211 (b), • at first GMS • thereafter mandatory *annual* election of directors GMS; § 214 allows cumulative voting.	art. 3, 5th Dir (13-12-1972/C 131/ 49 *as withdrawn in 2004)*, SB will appoint members of the BoM.	art. 2:132 (1), • initially appointed in the deed of incorporation • thereafter by GMS; art. 2:162, 'structuurregime'(*rare for issuers)* by SB; 2:133 (1), (2) binding nomination allowed, GMS (2/3 of votes more then 1/2 issued share capital) can waive binding character, NCGC IV.1.1 absolute majority of the casted votes representing 1/3 of the issued share capital; DCGC III.5.13 on selection and appointment cmmt.	sec.12, • initial registration to Reg. of Com; particulars of first directors; § 160 appoint. public com. directors voted on individually; § 5.1.2 GCGC Mpca[1] art.20 • rotation 3-year cycle • filling vacancies each GMS; sec. A.7 CC, all directors should be submitted for re-election at regular intervals; A.7.1, all directors should be subject to election by shareholders at the first GMS after their appointment, and to re-election thereafter at intervals of no more than three years; sec. A.4 CC procedure for the appointment of new directors and nomination committee.	§ 84 (1) BoM is mandatorily appointed by the SB for terms up to 5 years; According to § 33 MitbestG a labour director (Arbeitsdirector) will be appointed in the Vorstand; GGCC, § 5.1.2, for first time appointments the maximum possible appointment period of five years should not be the rule. A re-appointment prior to one year before the end of the appointment period with a simultaneous termination of the current appointment shall only take place under special circumstances.
Removal of directors	§ 8.08 (a), • SH with or without cause • art. of inc. allow 'only for cause' (b) elected by voting group of SH, this group power of removal (c) i.c.o. cumulative voting, number of shares required that also is sufficient for election.	§ 141 (k), with or without cause, majority shares;classief board only with cause (k) (1); cumulative voting, less then entire board, not without cause (k) (2).	art. 13 (1), 5th Dir., SB has authority to remove directors BoM.	art. 2:134 (1), by GMS,(2) art. of inc. allow increased majority, not more two-thirds of the votes (> 1/2 of issued capital) fot removal of directors; 2:162'structuur-regime by SB.	sec.168, by ordinary resolution (simple majority of votes) at meeting without cause.	§ 84 (3), only for urgent cause by GMS. Withdrawal of confidence by GMS counts as such cause.

1 Model public company articles

Appointment, suspension and removal of SB			art. 13 (2), 5th Dir., • SB removed by same organ or persons that appointed them; • unless appointed by SB; then due to important reasons on request of SB, GMS or employees' representatives by court order.	art. 2:142 appointment by GMS; 2:143 art. of incor. allow 1/3 of SB not by GMS; 2:144 SB-members can be suspended and removed by the one that is authorized to appoint; 2:158 (4), 'structuur-regime', GMS appoints SB on recommendation of the SB , (5) the GMS and the labour council can give their advice, (9) GMS with absolute majority representing the 1/3 of the issued capital decline the recom. of the SB, (12) art. of incor. can deviate from the above except sub 9. 2:161, on request of the firm, or SH/ labour council's representative the Enterprise chamber can remove a SB-member; 2:161 (a), GMS abolute majority representing 1/3 of issued capital can remove SB.		§ 101 (1) the GMS elects partly the SB-members, the other part is appointed by representatives of the employees by virtue of § 6-24 MitbestG. For a AG with 500-2000 employees 2/3 is appointed by the GMS and 1/3 by the employees (BetrVG); AktG 102(1) for period maximum up to 5 years, AktG § 103 (1), (3), dismissal of SB is, unless otherwise provided in the art. of incor., possible only by ¾ of the votes cast by GMS.
Adoption annual accounts/ financial report	No adoption by GMS, however Rule 14a-3 (b) SEA'34, solicitation on behalf issuer (registrant) relating ot annual meeting at which directors are to be elected, proxy statement accompanied by annual report (incl. annual report on Form 10-K).	idem	art. 48 5th Dir.; 4th /7th Dir, IAS Reg.,no AGM-approval or adoption; See however arts. 50b/50c 4th Dir. and arts. 36a/36b 7th Dir. on *collective duties of the administrative, management or supervisory body* for the accounts and report (accordance to dir. and issuers IFRS).	2:101 (1) Within 4 months after the end of the financial year annual accounts are drawn up by BoM and lays them down for inspection by the shareholders at the office of the company; (2) BoM/ SB shall sign the accounts (3) GMS adopts the annual accounts.	§ 414, • annual accounts are adopted by the board; • signed by a director of the company; § 437 accounts will be 'laid before' the AGM.	§ 172 and § 173,adoption by either BoM and SB, however the adoption accounts ('approved')accounts may be left to the AGM.
Discharge of directors and commissioners	Unknown in US, BJR gives a general defencealso in a derivative suit, a possible securities fraud action (against issuer) is not affected by this defence.			art. 2: 101 (3), GMS power to discharge Directors and SB; adoption annual accounts shall not as such discharge; Best Practise IV.1.6 DCGC, divides discharge of directors and commissioners in separate items on the agenda to be resolved by the GMS.		§ 120 (4) GMS each year resolves on the discharge (Enlastung) of directors and commissioners.

Distributions to shareholders	§ 6.40, board subject to restrictions articles of incor and limitation in (c) = distribution test.	§ 170 (a), BoD decides on dividends (1) out of surplus, (2) or out of profit last two fiscal years.	art. 15, 2nd Dir., no distribution to SH when on closing date last financial year the net assets are lower than the amount of the subscribed capital plus those reserves which may not be distributed under the law or the statutes.	art. 2:101 (6), 2:105 (1),(3), GMS decides after adoption or approval of the annual accounts the profits shall accrue to the shareholders, unless articles provide otherwise; DCGC IV.1.4, IV1.5. requires a resolution on dividends to be inserted as separate agenda item at the GMS.	art. 69 (2) Mpca, recommendation from the board and shareholder approval.	§ 119 (1) (2) and 174 GMS decides on dividens.
Remuneration policy	§ 8.11 Board may fix compensation of directors, unless articles or bylaws provide otherwise; Item 9-22 of SEA'34 Schedule 14A, compensation plans have to be added to the proxy statement; NYSE listing standards, Rule 4350-5 shareholder approval all stock option plan, except in case of new employees or in connection to. merger/acquisition.	§ 141 (h), Board authority to fix compensation directors; Item 9-22 of SEA'34 Schedule 14A, compensation plans have to be added to the proxy statement.	EC Recommendation on Directors' Remuneration (2004/913/EC), II.3.1, listed companies disclose statement of the remuneration policy as part of annual accounts/ report and companies' website; II 3.3 information on • fixed and variable pay • performance criteria for variable components*parameters for annual bonus scheme etc.; II.4(4.1.) remuneration should be item in the agenda for GMS; (4.2) remuneration statement should be submitted to the GMS for a vote; quorum required of 25%; unless national law differs; IV.6 share-based remuneration should be based on shareholder approval.	art. 2:135 (1) GMS adopts remuneration policy,(3) remuneration of directors according to the policy, adopted by GMS, unless art. of incorp. authorize other organ (4) • payment in shares or options on shares • art. of incorp. authorizes other organ • proposal for approval to GMS. DCGC III.5, SB more then 4 members, also remuneration cmmt; III.5.10 duties: • proposal to SB concerning remuneration policy (remuneration structure, amount fixed and variable pay, performance criteria etc), also for individual members • preparing the remuneration report (II.2.9); III.5.11 and 5.12 on incompatibility of functions, i.e. remun. cmmt, not chaired by chairman of the SB.	§ 420 (1) directors quoted company prepare a directors' remune-ration report for each financial year; § 439 SH have an advisory vote on the report; Mapc, art. 12 and 22 Board power to set directors' remuneration , the director whose remuneration is at issue is not usually permitted to vote on the matter; CC.B.1.3 SH's approval for pay in share-options to NED's required; LSE Listing Rules, 9.4, SH's approval for certain share option schemes and other long-term incentive plans for directors; LR 9.4.2., exception on SH's approval, option scheme is used in unusual circumstances for the recruitment or retention of the relevant individual.	§ 87 and § 89, SB decides on remuneration of and loans to directors; § 113 (1) AktG normal remuneration of SB members is set in articles of association or by the GMS; § 114 (1) (2) additional consultancy contract with SB member, its effectiveness, including the remuneration components, is dependent on assent by the whole SB; sec. 4.2.3 GCGC, SB determines the total compensation of the individual BoM at proposal cmmt, sec. 4.2.4 GCGC, the total compensation of each one of the members of the BoM is to be disclosed by name, divided into fixed and variable compensation components.

Appointment accountant/ auditor	§ 10 (a) (m) SEA'34, audit cmmt responsible for appointment, compensation and oversight outside auditor.	idem	art. 55 (1), 5th Dir. GMS appoints the auditor.	art. 2:393 (2), the GMS appoints the controlling accountant, unless other ways provided; NCGC V.2, GMS appoints the external auditor, SB nominates a candidate, Audit Cmmt and BoM give advice; NCGC V.2.1, the external auditor may be questioned by the GMS.	sec. 489 (4) GMS has in general power to appoint auditor, (3) Board has default power; sec 490 for default power Secretary of State.	§ 119 and jo. 318 (1) HGB, the GMS appoints the accountant.
Important change identity or character of the corporation	§ 12.01 no approval SH, sales etc. of all assets in usual and regular course of business, §12.02.shareholder approval for the sale of all assets, if thereafter corporation without a significant continuing business activity, presumed less than 25% of all assets; § 12 (b) initiated by resolution BoD; § 12 (e), quorum of majority vote of shares is necessary.	§ 271 (a), authorized by majority (no quorum) SH entitled to vote on 'sales, leases or exchanges of all or substantially all of the corporation's property and assets; No vote for purchase substantial assets, also not for purchase for shares; NYSE Listing Rules 312.03 (c), shareholders approval required in case of issue of 20% or more of their outstanding stock in a single transaction.		art. 2:107 (a) GMS authority to approve a decision with as consequence an important change of the identity or character of the corporation; Best Practise IV.1 DCGC, GMS approves any decisions of the BoM on a major change in the identity or character of the company or the enterprise; Best practise V.1.3 public statement BoM in case of private bid exceeding threshold art. NCC 2:107 (1) (c).	LSE Listing Rules, nr. 10 'Class 1-tranctions (> 25% of companies' assets) require GMS approval.	§§ 119 (1) (no. 5), 179 (a) and 293. See Case-law Holzmüller and Gelatine; § 2.2.1 DCGC the General Meeting resolves on the Articles of Association.
Underhand offer				Best Practise IV.1.3 public statement BoM in case of private bid exceeding threshold art. 2:107 (1) (c).		
Public tender offer				Art. 18 Decree Public Offerings, in case of public offer for the shares of a public corporation a GMS will be held to discuss the offer and the reaction of the board of the offeree.		§ 16 WpUG, No requirement for convocation of an informative general meeting; sec. 3.7 GCGC. BoM (of target) should convene an extraordinary General Meeting at which shareholders discuss the takeover offer and may decide on corporate actions.

Structure regime				art. 2:154 (4), the GMS decides on a proposal whether or not to continue with application of the structure regime, when the public corporation no longer fulfil the 'structure-criteria'.		ch. 4, part 1 and 2 AktG, companies subject to the AktG, divide the governance functions between a supervisory board (*Aufischtsrat*) and a managing board (*Vorstand*). Company with more than 500 workers, one third of the members of the supervisory board are employee representatives (*Betriebsverfassungsgesetz* 1952, ss 76-77); where it employs more than 2000 workers, half the members are employee representatives (though the chair, who is usually a shareholder representative, has a casting vote): *Mitbestimmungsgestz* 1976, s 77. Thus, an AG will be not be subject to codetermination if it employs 500 or fewer workers.
Conflicting interests	§ 8.60-8.63, conflict of interest transaction not voidable by the corporation if 1) appropriately approved by *disinterested* directors or SH, 2) the interested director establishes the fairness of the transaction.	§ 144, conflict of interest transaction not voidable, 1) appropriately approved by majority of the *disinterested* directors, 2) appropriately approved in good faith by majority of the SH 3) the transaction is fair to the corporation.	art. 10 (1) 5th Dir., every agreement to which the company is party and in which a member of the management organ or of the supervisory organ has an interest, even if only indirect, must be authorized by the supervisory organ at least.	art. 2: 146, corporation will be represented by SB, unless art. of incorp. provide otherwise; GMS can appoint one or more other persons for that purpose; Best Practise II.3 DCGC, conflict of interest between the company and BoM shall be avoided. SB approves conflict of interest decisions that are material; Best Practise III.6 DCGC, Same for conflict of interests between company and SB members; The SB is responsible for deciding on how to resolve conflicts of interest between BoM-,SB-memb., major SH's and the external auditor and the company.	sec. 175 (1) directors has duty to avoid situations where he has a conflict of interest with the company; (5) (b) authorisation by the directors— in case of public company and its constitution includes provision enabling the directors to authorise the matter. (6) authorization only effective if (a) director himself doesn't count in the vote nor (b) cast a vote himself.	§ 88 provides a legal competition prohibition, SB has to approve; sec. 5.5 GCGC supplies some general rules in case of conflicts of interest; see also § 311 (Konzernrecht) and further addresses, among other things the conflicts of interest that may arise in transactions between a corporation and its controlling shareholder.

Substantial alteration in governance structure corporation	303A.09-10 NYSE Listing Rules Manual; § 406 SOx, the company must make it clear whether it follows a code (of ethics for senior financial officers, applicable to its principal financial officers and comtroller or principal accounting officer, or persons performing similar functions) or give an explanation of why this is not the case.			Best Practise I.2 DCGC, each substantial change in the corporate governance structure of the company and in the compliance of the company with the code shall be submitted to the GMS for discussion under a separate agenda item.		§ 161, mandates that BoM and SB state annually which provision of the corporate governance codex they apply and which they don't adhere to.
Issue of shares and delegation to another body corporate	§ 6.21 authorizes the board, power may be transferred to the SH by art. of incorp.	§ 152, authority board.	art. 25 (1) 2nd Dir.(77/91/EEC), any increase in capital must be decided upon by the GMS, art. 25 (3) delegation to another organ of the company for maximum period of 5 years is allowed.	art. 2:96 (1) company can issue new shares as authorized by GMS's or another companies' organ decision; delegation to another organ of the corporation according to GMS's decision or by art. of inc. for a maximum of 5 years is allowed.	secs. 549 and 551, board can issue new shares, if authorized by articles or companies' resolution (simple majority vote GMS).	§ 119 (6), in principle the GMS decides on case of increase in capital; § 182, GMS decides on increase in capital with majority of 3/4; § 202 increase in capital by issue of new shares, GMS can decide with 3/4 majority to delegate this power to the BoM for 5 years.
Buy-back own shares	§ 6.31 (a), a corporation may acquire its own shares, and shares so acquired constitute authorized but unissued shares.	§ 160, a corporation may repurchase its own shares, provided that is may not do so if its capital is impaired or if the redemption would cause its capital to be impaired; § 160 repurchase of its own shares out of capital is permitted provided the corporation reduces its capitaql pursuant to §§ 243 and 244.	art. 19 (1) 2nd Dir., MS may permit a company to acquire its own shares, under conditions, e.g. (a) authorization by GMS, which determines terms and conditions, not exceeding 5 years, (c) only fully paid-up shares. art. 19 (1) (i), not exceeding a limit determined by MS, not lower then 10% subscribed capital (default rule).	art. 2:98, a corporation may buy back its own shares under certain criteria, (1) shares have to be fully paid, (2) corporation can acquire the share only for free or when the nominal value of the acquired shares in its capital is not more than the placed capital, (4) in other cases the GMS has to give the BoM a proxy for maximum of 18 months, the art.of incorp. may exclude or limit buy-back of shares by the company.	sec. 690, a company may purchase its own shares (including redeemable shares) subject to any restriction or prohibition in the companies' articles; § 701 (1) purchase of shares by the company only if the purchase has first been authorised by a resolution (simple majority vote GMS)of the company; LR 12.2.2., re-purchases of more than 15% of the outstanding shares need to be a tender-offer to all shareholders (of the class).	§ 237 the company can withdraw its own shares when stated in the articles or when the articles are amended with majority decision of 3/4 by the GMS (normal procedure for capital increase); see also Reduction of capital.

Pre-emptive rigths	§ 6.30 (a), SH no pre-emptive rights unless articles of incorporation so provide (opt-in), see § 6.30 ((b) for conditions.	§ 157 (a) Subject to any provisions in the certificate of incorporation, every corporation may create and issue, whether or not in connection with the issue and sale of any shares of stock, rights or options entitling the holders thereof to acquire from the corporation any shares of its capital stock of any class or classes as shall be approved by the board of directors.	art. 29 (1) 2nd Dir., increase in capital shares must be offered on a pre-emptive basis to SH (4) righs of pre-emption not restricted or withdrawn by statutes or articles, only by GMS acting in accordance with quorum and majority rules laid down in art. 40.	art. 2:96a, every shareholder with issue of shares according the ratio of their combined amount of shares, art.2:96a (6) (7), GMS as well as designated companies's organ can limit or exclude pre-emtipve right, for decision to limit, block a majority of 2/3 is necessary, when less of 50% of outstanding capital is present.	sec. 561, no issue of shares, unless the company has made an offer to existing SH on the same or more favourable terms a proportion of those securities that is as nearly as practicable equal to the proportion in nominal value held by him of the ordinary share capital of the company.	§ 186, every shareholder has a pre-emtptive right with issue of shares according to the ratio of their combined amount of shares, § 186 (2) this right can be excluded by a majority decision (3/4) of the GMS (or as art. of incorp. determine).
Reduction of capital	§ 10.05, the board may adopt amendments to articles of incorp. without SH's approval: (6) to reflect a reduction in authorized shares (§ 6.31 (b)), when corporation has acquired its own shares and articles prohibit the reissue of the acquired shares.	§ 244, by resolution of the board the corporation may reduce its capital.	art. 30, 2nd Dir., reduction in capital, must be subject at least to a decision of the GMS in accordance with quorum and majority requirements; art. 40 (1) majority of not less than 2/3 of the votes represented, (2) MS allowed to lay down that simple majority of the votes is sufficient, when at least 1/2 of the subscribed capital is represented.	art. 2:99 (1) the GMS can decide to reduce the capital of the corporation by withdrawal of the shares or by decreasing the amount of the shares by amending articles of incor.; art. 2:100 the corporation lays decision with the commercial register and will announce that in national newspaper.	sec. 641 (1), a company having a share capital may reduce its share capital (b) in any case, by special resolution confirmed by the court; § 283 Special resolutions (1) A special resolution of the members of a company means a resolution passed by a majority of not less than 75%.	§ 119 (6) general provision on power of GMS to decide on alteration of capital; there are three ways of capital decrease; the normal (ordentiliche) capital decrease (§§ 222-228), the simplified capital decrease (§§ 229- 236) and the capital decrease through withdrawal of shares (§§ 237-239);§ 237 the company can withdraw (!) its own shares when stated in the articles of incorp. or when the articles of incorp. are amended with majority decision of 3/4 by the GMS (normal procedure for capital increase).

Alteration of articles of incor-poration/ Bylaws	§ 10.03 (a) Board adopts proposal for amend-ment, (b) after adoption Board, GMS approves; see § 10.05 for authority Board to amend articles without shareholder approval; § 10.20, power to amend or repeal the corporation's bylaws is shared by the Board and SH; § 10.21 limits the power of directors to adopt or amend supermajority provisions in bylaws.	§ 242 (b) (1) on initiative of the Board by a majority of the shares eligible to vote; § 109(a), sharehol-ders have the authority to adopt, amend or repeal by-laws, however aricles of incorp. may confer power to Board, SH are still equally empowered.	art. 39 (1), 5th Dir., GMS needs majority of not less than 2/3 of shares represented at the meeting for passing of resolutions altering the statutes; (2) where MS laws require 1/2 subscribed capital be represented at the meeting, resolutions for alteration of the statutes shall require a majority not less than that required under art. 36; art. 36 (1), resolutions of GMS shall be passed by *absolute* majority of votes cast by all SH's present or represented, unless a greater majority or other requirements be prescibed by law or by statutes.	art. 2: 121 (1), GMS authority to alter the articles of incorp., as far as the authority to alter art. Of incorp. has been excluded, alteration still possible with 100%-vote with a quorum of the outstanding capital, (2) art. of incorp. stipulate alteration only under certain conditions, then this articles only altered under the same conditions, (3) art. of incorp. that forestalls amendment of one of more other articles, same as criteria as under (1).	sec. 21 and sec. 283, a corporation may amend its articles of incorporation by special resolution (3/4 majority).	§§ 119 (1),nr. 5 and 179 (1), GMS is allowed to amend articles, § 179 (2) decisions on alteration of article have to be taken by majority of 3/4 or higher as set by the articles,§ 179 (1) decisions on alterations that relate only to 'der fassung' can be delegated to the SB; § 202 in case of capital measures the BoM can be authorized to alter the art. of incorp. as consequence of these involved decisions.
Conversion	§ 9.50, a domestic business corporation may become a domestic unincorporated entity pursuant to a plan of entity conversion.			arts. 2:18 (3), 2: 71 and 2:100 a public company can converse itself to a private one and the other way around under, 2:18 (2) (a), conversion decision same requirements as alteration art. of incorp.	sec. 97 (1), public company can convert to a private company by passing a special resolution.	§ 193 (1) UmwG, only the GMS can decide on a conversion of the corporate form.

Legal merger	§11.04 (b), after adopting the plan of merger or share exchange the board must submit the plan to the SH for their approval, § 11.04 (e), approval of the plan of merger or share exchange requires the approval of the shareholders at a meeting at which a quorum consisting of at least a majority of the votes entitled to be cast on the plans exists; § 11.04. (g), under certain criteria shareholder's approval is not required; § 11.04 (b) (e) for approval SH disappearing corporation; §11.05, no shareholder approval of the acquiring and target shareholders when acquiring company holds 90 % or more of the stock in another corporation.	§ 251 (c) requires a majority vote by the outstanding stock of each constituent corporation that is entitled to vote; preferred stock not protected with the right to a class vote under DGCL; however under § 242 (b) (2) preferred stock have class voting rights if their rights are adversely affected by a charter amendment; § 253, allows a 90 per cent shareholder to simply cash out a minority unilaterally.	art. 7 (1) 3rd Dir., GMS of each of the merging companies shall approve decision requiring majority not less than 2/3 of votes represented; MS may provide simple majority votes sufficient when at least 1/2 of subscribed capital is represented; moreover, where appropriate Rules governing alterations memorandum and articles apply.	art 2:317 (general article) (1) GMS will adopt a resolution to merge; (3) resolution to merge shall be adopted in the same manner as a resolution for the amendment of the articles; art. 2:330 in case of public corporation, if less than one half of the issued capital is represented at the meeting, at least a two-thirds majority shall be required of the general meeting for adopting a merger resolution.	sec.907 (1), the scheme must be approved by a majority in number, representing 75% in value, of each class of members of each of the merging companies, present and voting either in person or by proxy at a meeting; sec. 912 in case of a merger by formation of a new company, the articles of the transferee company, or a draft of them, must be approved by ordinary resolution of the transferor company or, as the case may be, each of the transferor companies.	§ 13 (1) UmwG the GMS of both companies has to approve the merger agreement; UmwG § 65 (1) a majority of 3/4 has to decide on the merger, the articles can require a larger percentage.
Exception on approval by holders of surviving corporation	§§ 11.04(g) and 6.21 (f), any merger that does not increase the outstanding shares of the acquiring company by more than 20% ordinarily need not be approved by the acquiring corporation's shareholders.(small-scale-mergers)_	§ 251 (f) no voting rights on merger surviving corporation when: a) art. of incorp. are not amended; b) outstanding shares are unaffected by the transaction;c) transaction does not increase the number of outstanding shares by more the 20 %; § 262, shareholders of the surviving company are denied appraisal rights in such a transaction.	art. 8, 3rd Dir, laws of MS need not require approval of the merger by the GMS of acquiring company if following conditions are fulfilled: (a) (b) disclosure and inspections requirements for SH are fulfilled, (c) SH's acquiring company with min. percentage, not more than 5%, entitled to require GMS to approve the merger; Cf. art. 27, no shareholder approval acquiring required when holding owns 90 % of that company, nb. art. 8 (c) still applies.	art.2:331, unless the articles otherwise provide, a surviving company may resolve to merge by a resolution of the BoM/SB; art.2:331 (2), resolution may not be adopted when one or more shareholders who jointly represent at least one-twentieth of the issued capital or such lesser amount as is provided in the articles, have requested the BoM/SB, within one month after its announcement, to convene a general meeting in order to resolve on the merger.	sec. 916 (1) applies if 90 % securities of the target company are held by or on behalf of the surviving company; 916 (2), no approval of scheme by members of the surviving company, if: amongst other criteria, (5) (a) members of the surviving company, not less than 5% of voting rights at GMS would have been able to require a meeting with purpose of deciding whether or not to agree to the scheme, and (b) no such requirement was made.	§ 62 UmwG, no decision of GMS is required when already 90% of shares of disappearing company is in hands of the surviving company. UmwG, unless 5% of the shares orders a GMS to decide on the approval.

Legal division			art. 4, 6th Dir., division requires approval of a GMS of each company involved, art. 7 of the 3rd Dir. shall apply with regard to the majority required for such decisions, their scope and the need for separate votes; see art. 5 (2) for minority SH protection through by-out; art. 6 under conditions no approval required of GMS of a recipient company, minimum % of 5 entitled to require a GMS.	art. 2:334f (1) BoM of the parties to a division shall prepare proposed terms of division; art. 2:334m (1), a decision resulting into a division shall be adopted by the GMS, (3) this decision shall be adopted in the same manner as a decision altering the art. of incorp.	sec. 920 (1), a draft of the proposed terms of the scheme must be drawn up and adopted by BoM of the companies involved in the division; sec. 922 (1) the division must be approved by a majority in number, representing 75% in value, of each class of members of each of the companies involved in the division; sec.928 GMS approves articles of new transferee company (division) by ordinary resolution.	§ 125 UmwG refers to § 13 UmwG, meaning that the GMS has the power to decide on division of the corporation and § 62 UmwG meaning that when already 90 % of the shares is in hands of the acquiring company no decision of GMS is required.
Dissolution	§ 14.02 (a), Board may propose dissolution for submission to the SH, (b) (2) the SH entitled to vote must aprove the proposal to dissolve, (e) quorum consisting of at least a majority of the votes entitled to be cast is required.	§ 275, Board will adopt resolution for dissolution; a majority of the outstanding stock required for proposed dissolution.		art. 2:19, a legal person shall be dissolved amongst others (wound up) by a resolution of its general meeting.	§ 1003, striking off on application by company, (1) on application by a company, the registrar of companies may strike the company's name off the register, (2) the application (a) must be made on the company's behalf by its directors or by a majority of them, and(b) must contain the prescribed information.	§ 119 (1) nr.8 and § 262, GMS of shareholders will decide on dissolution, 3/4 majority of outstanding capital is required, articles can require larger majority.
Apply for bankruptcy		§ 291, whenever a corporation shall be insolvent, the Court of Chancery, on the application of any creditor or stockholder thereof, may, at any time, appoint 1 or more persons to be receivers of and for the corporation.		art. 2:136, BoM may not, without a mandate from the GMS, file for the bankruptcy of the company.	sec. 84 (1) (b) Insolvency Act, a special resolution is required for voluntarily winding-up of the corporation.	§ 92 (2), the BoM has the power to file for the bankruptcy of the company.

GROUP AND INDIVIDUAL RIGHTS OF SHAREHOLDERS						
Items on the agenda	Rule 14a-8 SEA'34, in the US shareholders owning 1% or more (or equivalent of 2000 USD) and with ownership of at least 1 year bring in certain proposals in the proxy material. See annexes on securities regulation.		art. 25 (1), 5th Dir., one or more SH, who (see art. 16, hold minimum stake: (a) shares not more than 5%, or (b) units not more than EUR 100.000,--), may request that one or more items be included in the agenda of a GMS; art. 6 (1) Shareholder Rights Dir., SH acting individually or collectively: a) have the right to put items on the agenda, b) right to table draft resolutions for items included or to be included on the agenda, (2) requirement of minimum stake not exceed 5% of share capital, (3) deadline for exercising agenda rigth; Cf. also art. 9(1), every SH shall have the right to ask questions related to the items on the agenda of the GMS.	art. 2: 114a (1), SH owning 1% or more of the shares or representing a value of 50 million euros can put an item for discussion on the agenda of the general meeting, if filed in time (60 days) the item will be inserted in the notice of the meeting, unless 'important interests of the corporation' opposes such insertion,(3) articles can lower these thresholds, (4) certificates of shares (preferent shares) are treated equivalently.	sec. 338 (1), (3), members representing at least 5% of the total voting rights of all the members who have a right to vote on the resolution at the GMS to which the requests relates (b) at least 100 members who have a right to vote on the resolution at the GMS to which the requests relates and hold shares in the company with paid up an average sum, per member, of at least £100, unless (2) (a) it would, if passed, be ineffective,(b) it is defamatory of any person, or (c) it is frivolous or vexatious.	§ 122 (2), SH have a right to supplement items on the agenda of the meeting when they hold 5% or EUR 500.000,-- of the issued capital, § 142 (2) SH holding shares more than 3 months, § 124 (1) (2), SH are allowed 10 days after the notice of the meeting to put items on the agenda. The BoM has the power to exclude an item if it is related to 'ordinary business', §§ 126 and 127, SH can bring in counterproposals with regard to items on the agenda.
Requirement to hold an annual GMS	§ 7.01 (a), a corporation shall hold annually at a time stated in or fixed in accordance with the bylaws a meeting of shareholders.	§ 211(b), unless directors are elected by written consent in lieu of an annual meeting, an annual meeting of stockholders shall be held for the election of directors on a date and at a time designated by or in the manner provided in the bylaws.	art. 22 (1) 5th Dir., the general meeting shall be convened at least once each year.	art. 2:108 (1) annually a general meeting of shareholders will be held in *6 months* after the financial year or (2) a shorter period when provided for in the articles.	sec. 336 (1), every public company must hold a general meeting as its annual general meeting in each period of 6 months beginning with the day following its accounting reference date (see sec. 336 (1)).	§ 175 (1) in 8 months after the start of the financial year a annual GMS shall be held.

Other General/Special meeting.	§ 7.02 (a) (1) directors or person(s) authorized by bylaws or articles have the power to call special meeting, (2) shareholders of at least 10% of the votes are authorized to compel the holding of a special meeting on written demand to corporation stating the purpose of the meeting.	§ 211 (d), only by board of directors, persons authorized in articles of incorporation or by the bylaws; See also § 228 shareholder consent solicitations.	art. 22 (2) 5th Dir., (2) it may be convened at any time by the management organ.	art. 2: 109, the BoM/SB have the power to convene a general meeting; the articles may also vest such power in other persons.	sec. 302, the directors of a company may call a general meeting of the company; Art. 27 Mpca art. 27 gives members power to convene meeting when the number of directors falls below two and the remaining director is unwilling to appoint a further director; sec. 303 (1), (3), directors must convene a meeting on the requisition of holders of not less than 10 % of the paid-up capital carrying voting rights, (4), the request must state the general nature of the business to be dealt with at the meeting, (5), only resolution which can be properly moved at a meeting (see sec. 303 (5); secs 304 and 305, if directors fail to convene a meeting within 21 days of the deposit of the requisition, the meeting to be held within a further 28 days of the notice convening it, the requisionists representing more than 1/2 of the total voting rights, may themselves convene the meeting.	§ 121 (2) the BoM has the power to convocate a GMS, § 122 (1), allows shareholders owning 5% of the shares to convene a GMS.
Meetings convened by court	§ 7.02 (a) (2) empowers holders of at least 10% (art. of incorp. may fix higher percentage not exceeding 25%) of the voting shares to call a special meeting.	§ 211 (c), if board fails to hold an annual meeting within 13 months of the last meeting, the Court of Chancery may summarily order a meeting to be held upon the application of any stockholder or director.	art. 23 (2) 5th Dir., no action by company to convene a GMS within one month according to art. 23 (1), the competent court has power to convene or authorize the convocation.	art. 2:110 (1), SH representing at least 1/10 of the issued capital or such lesser amount as is provided by the articles, may, on their application, be authorised by the interim provisions judge of the court to convene a general meeting; only if the BoM/SB had the opportunity to resolve upon the raised matters.	sec. 306 (1), court has the power to convene a meeting 'if for any reason it is impractible to call a meeting', this power may be exercised by the court 'of its own motion or on the application (a) of any director of the company or (b) of any member who would be entitled to vote at the meeting.'	§ 122 (3) the court can give shareholders (at least 5%) a proxy for convening a GMS, the court will then appoint the chair.

Holders of depositary receipts/ non-voting shares	See annexes under class voting.	See annexes under class voting.		art. 2:118a (2),holders of depositary receipts issued for shares can always vote in the general meeting, except in 'times of war' NCC 2:118a (2).	UK listing Rules provide that the voting right revives if no dividend has been paid for six months.	§ 12 (1), non-voting preference shares may be issued; §§ 139 (1) and140 (1) and (2), voting rights may be excluded, these will revive if the preference has not been granted for two years in succession.
Correction of annual accounts	Restatement procedure under federal securities regulation.			Art. 2:447 and further, AFM may request a judicial order of the Enterprise Chamber to 'correct' the accounts. This action can be brought only after adoption of the accounts by the GMS. Also any 'interested person' can bring a similar action.The Decree on Supervision Financial Reporting elaborates the authority of the AFM, amongst other the AFM may recommend the issuer to disclose a statement to explain deficiencies in the annual financial report.	secs. 455-458, the Secretary of State, finding that the published financial report does not comply, may give notice to the issuer and request for an explanation or to prepare revisions within one month, if a satifactory explanation has not given or revisions prepared, he may apply to the court; sec. 457 certain qualified third parties may by the Secretary of state to bring such proceedings.	§§ 37n-37u WpHG, Bundesanstalt investigates on the ground of concrete indications or at random. Such procedure will be blocked if corporate law action for annulment of annual financial report has been brought or § 37o (2), a Sonderprüfer has been appointed; § 342a-e Prüfstelle may inform BaFin that issuer refuses to follow its recommendations; § 37q BaFin can establish shortcomings and order issuer to announce and disclose these deficiencies.
Annulment of GMS's / board's decisions	Regulated in case law; business decisions are protected by BJR.			art. 2:14, a decision of the GMS, or another organ is null if the decision violated a statutory provision or a provision of the art. of incorp; art. 2:15, a court can void a resolution on the ground that a) the decision violated either a statutory provision or a provision of the art. of incorp. regulating the realization of the decision, b) in case of violation of notions of reasonableness and fairness as required by art. 2:8, c) in case of violation of regulations.		§ 243, allows for challenging the GMS's decision on the ground that the decision violated either a statutory provision or a provision of the art. of incorp.; § 243 (4) a failure to provide information which a reasonable shareholder does not perceive as relevant for his voting decision, does not justify the contest of a GMS's decision; § 246a providing a compensation procedure to prevent obstructive actions.

Assignment Board/SB	§ 8.01 (a), each corporation must have a Board of Directors; § 8.01 (b), all corporate powers shall be exercised by or under the authority of, and the business and affairs of the corporation managed by or under the direction of, its Board of Directors	§ 141 (a), the business and affairs of every corporation organized under this chapter shall be managed by or under the direction of a Board of Directors		art. 2:129 the corporation will be managed by the BoM.	arts. 3 and 4 MAPC, subject to the provisions of the act, the memorandum and the articles and to any directions given by a special resolution, the business of the company shall be managed by the directors who may exercise all the powers of the company.	§ 76 (1), the management board shall manage the company under its own responsibility.
Business Judgement Rule	§ 8.31 (a)(2), directors not liable to the corporation or its shareholders for any decision, unless, challenged conduct consisted or was the result of: i) action not in good faith; or (ii) a decision (a) director not reasonable believe in best interest corp. or (b), director was not informed to an extent the director reasonably believed appropriate in the circumstances; or (iii) a lack of objectivity due to self-interest director. (iv), a sustained failure of the director to devote attention to on-going oversight of the business and affairs of the corporation (v), receipt financial benefit director not entitled to or other breach of duty of loyalty	There is not canonical statement of the Business Judgement Rule. The core idea, however, is universal: Courts should not second-guess good-faith decisions made by independent and disinterested directors (see Allen, Kraakman and Subramanian, Commentaries and Cases on the Law of Business Organizations, 2007, p. 252.). The American Bar Association's Corporate Director's Guidebook provides however the following formulation: 'a decision constitutes a valid business judgement (and gives rise to no liability for ensuring loss) when it 1) is made by financially disinterested directors or officers, 2) who have become duly informed before exercising judgement and, 3) who exercise judgement in a good-faith effort to advance corporate interests				§ 93 (1), 2:'Eine Pflichtverletzung liegt nicht vor, wenn das Vorstandsmitglied bei einer unternehmerischen Entscheidung vernünftigerweise annehmen durfte, auf der Grundlage angemessener Information zum Wohle der Gesellschaft zu handeln', see AktG § 116 for SB

Derivative suit	§§ 7.40-7.47, derivative suits are allowed under the statute; cf. § 7.42 on a written demand, § 7.44 dismissal by the court after inquiry special investigation committee and § 7.46 on expenses of the proceeding.	§ 327 stipulates that you have to be a shareholder at the time of the disputed transaction; derivative suit developed under case law.	art. 15 (1), 5th Dir., proceedings on behalf of the company to enforce the liability referred to in art. 14 (civil liability of the members of the management) shall be commenced if the GMS so resolves; art. 16, it shall be provided that proceedings on behlaf of the company to enforce liability of the members of the management shall also be commenced if so requested by one or more SH.		§ 260-264 law provides for a derivative suit; § 260(3), derivative claim only if there is a cause of action arising from an actual or proposed act or omission involving negligence, default, breach of duty or breach of trust by a director of the Company; § 261 (1), a member of a company who brings a derivative claim must apply to the court for permission to continue it.	§147, GMS resolution can compel SB to assert a claim against the BoM; § 147a SH with 1% of the overall shares or EUR100,000,-- in nominal capital have the right to induce a pre-procedure for shareholder suits, derivative suit; § 148, court admits an action only if SH has previously called on the company to file suit, damages appears to have arisen from dishonesty or gross breach of law and there are no overriding reasons of company welfare not to do so.
Inquiry procedure				art. 2: 344 – 359, SH, owning 10% of the shares or shares representing a nominal value of EUR 225.000, are entitled to petition for an investigation to be ordered in case there are well-founded reasons to doubt proper administration of the corporation and, if the court so finds, appoint one or more investigators to investigate the administration and course of affairs of the corporation, and 2) based upon the report of the investigators they may request the court to establish that this constitutes mismanagement and order specific injunctions; art. 2:349a, the court may grant injunctive relief if the court finds that the state of affairs so require.		

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